PROPOSALS IN THE PRESIDENT'S COMPETITIVENESS INITIATIVE THAT AFFECT FUNDING AND TERMINATION OF DEFINED BENEFIT PENSION PLANS

HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDREDTH CONGRESS

FIRST SESSION

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PROPOSALS IN THE PRESIDENT'S COMPETITIVENESS INITIATIVE THAT AFFECT FUNDING AND TERMINATION OF DEFINED BENEFIT PENSION PLANS

FRIDAY, MARCH 6, 1987

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON OVERSIGHT,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:07 a.m., in room 1100, Longworth House Office Building, Hon. J.J. Pickle (chairman of the subcommittee) presiding.

[The press release announcing the hearing and the funding proposal follow:]

FOR IMMEDIATE RELEASE
MONDAY, MARCH 2, 1987

PRESS RELEASE #4
SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
1102 LONGWORTH HOUSE OFFICE BLDG.
WASHINGTON, D. C. 20515
TELEPHONE: (202) 225-5522

THE HONORABLE J. J. PICKLE (D., TEXAS), CHAIRMAN, SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES, ANNOUNCES A HEARING ON THE PROPOSALS IN THE PRESIDENT'S COMPETITIVENESS INITIATIVE THAT AFFECT FUNDING AND TERMINATION OF DEFINED BENEFIT PENSION PLANS

The Honorable J. J. Pickle (D., Texas), Chairman of the Subcommittee on Oversight, Committee on Ways and Means, U.S. House of Representatives, announced today that the Subcommittee will conduct a hearing to examine the Administration's proposals included in the President's Competitiveness Initiative affecting the funding and termination of defined benefit pension plans. The hearing has been scheduled for Friday, March 6, 1987, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 9:00 a.m.

The Subcommittee will receive testimony only from representatives of the Department of the Treasury, the Department of Labor, the Internal Revenue Service, and the Pension Benefit Guaranty Corporation (PBGC). Additional hearings will be scheduled in the future at which time public witnesses will be given the opportunity to testify. These hearings will be announced in subsequent press releases.

In announcing the hearing, Chairman Pickle made the following statement: "The foundation of America's private pension system is the Employee Retirement Income Security Act of 1974 (ERISA). Under ERISA, we have a combination of regulations promoting sound pension plan funding practices and an insurance program guaranteeing payment of at least some benefits when insufficiently funded pension plans are terminated.

"In recent years a number of large and severely underfunded plans have terminated, increasing the liabilities and the deficit of the Pension Benefit Guaranty Corporation. At the same time, there has been a rise in the number of instances in which employers have terminated overfunded pension plans in order to recover the excess assets. Left unchecked, these trends could undermine support for the entire voluntary defined benefit pension system.

"Therefore, it is important that we give serious attention to the proposals included in the President's Competitiveness Initiative affecting the funding and termination of defined benefit plans. At this hearing, I look forward to beginning this review by receiving testimony from those most responsible for making the policy and administrative decisions affecting the defined benefit pension system."

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Any interested person or organization may file written comments for inclusion in the printed record of the hearing. Persons submitting written comments for the printed record should submit six (6) copies by the close of business, Friday, March 27, 1987, to Joseph K. Dowley, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, Room 1102 Longworth House Office Building, Washington, D.C. 20515.

SEE ENCLOSED FORMATTING REQUIREMENTS.

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THE ADMINISTRATION'S PROPOSAL ON THE FUNDING AND TERMINATION OF DEFINED BENEFIT PENSION PLANS

(Legislative Language to be Developed)

EXECUTIVE SUMMARY

I. BACKGROUND

Private pension plans constitute a major and increasingly important source of retirement income for American workers. In general, these plans are subject to the provisions of the Employee Retirement Income Security Act of 1974 (ERISA). One of the primary purposes of ERISA is to assure the adequate funding of defined benefit pension plans. To this end, ERISA imposes minimum funding standards, regulates the investment of plan assets, and strictly limits employer access to such assets. In addition, ERISA established the Pension Benefit Guaranty Corporation (PBGC) to guarantee certain benefits under defined benefit pension plans.

The rules established as part of ERISA (and subsequent amendments thereto) have largely accomplished their intended purpose. However, weaknesses remain that enable employers to act in ways that may jeopardize their ability to fulfill benefit promises they have made. Two particularly troubling trends have developed in connection with defined benefit plans that are either overfunded or underfunded in relation to their benefit obligations.

First, during the recent past, a significant number of employers have terminated their overfunded defined benefit pension plans in order to obtain, through asset reversions, the assets of plans that exceed such plans' termination liability to participants. Plan terminations are costly and disruptive. Even in the case where an employer continues to provide defined benefit plan coverage to its employees following a plan termination and asset reversion, such a transaction reduces participants' benefit security with respect to future benefit accruals and may also discourage the employer from granting ad hoc benefit increases or cost of living allowances for retirees.

Second, in spite of the minimum funding standards imposed by ERISA, many pension plans are currently underfunded to a substantial degree. Indeed, under the provisions of current law, the funding status of a plan may deteriorate even though an employer fully complies with the minimum funding standards and other requirements of ERISA. As a result, participants may not receive their full accrued benefits and the PBGC may be required to accept responsibility for some or all of such benefits.

The Administration believes that public policy should encourage optimal, rather than deficient or excessive, funding of pension obligations. An employer should have neither the incentive nor the opportunity to make pension promises that exceed its own

legal liability or financial capacity to keep those promises when they come due. The purpose of sound funding is to protect participants' benefits by insulating them from the business risk of the employer, as well as to protect the PBGC insurance system from systematic loss. In addition, for purposes of both tax policy and economic efficiency, employers should not be required to fund their benefit promises beyond a level that reasonably assures that such benefits will be paid when due.

The Administration's Proposal is designed to improve benefit security for plan participants in several ways. First, employers' access to surplus assets in overfunded defined benefit plans is limited and rationalized; second, the minimum funding standards are strengthened to increase the likelihood that defined benefit plans will be funded sufficiently to provide participants' accrued benefits; and, third, employers are made more responsible and accountable for their benefit promises.

II. MAJOR POLICY CONCEPTS UNDERLYING THE ADMINISTRATION'S PROPOSAL

A. Employers should be permitted to recover excess assets from ongoing defined benefit plans provided that certain conditions are met.

The Proposal permits employers to withdraw assets from ongoing defined benefit plans provided that, following the withdrawal, a sufficient asset cushion remains in the plan and all other plans maintained by the employer and the controlled group. The Proposal generally limits the amount that an employer may recover from a plan on termination through a reversion to the amount that could have been withdrawn from such plan. However if, following the termination, the employer and the controlled group cease to maintain any defined benefit plans, the employer may recover all assets in excess of termination liability. In such event, the employer (and its controlled group) would be precluded from establishing a defined benefit plan for a period of five years.

B. The minimum funding rules and deduction limits for defined benefit plans should be modified in order to improve the benefit security of plan participants and protect the PBGC.

The Proposal is directed at improving the funded status of plans that are underfunded on a termination basis. Such plans would be subject to the following requirements: (i) more rapid amortization of certain unfunded accrued liabilities and waived contributions; (ii) rapid amortization of future declines in fundedness, and (iii) a minimum funding contribution for a year based on the plan's distributions and expenses during the year. In addition, the Proposal would establish new protections for benefit security in all defined benefit plans by (i) making the

fundedness of a controlled group of plans the determining factor in deciding whether and to what extent any plan(s) included in such group may be the subject of a termination reversion or asset withdrawal transaction; (ii) accelerating the due date for minimum funding contributions; and (iii) limiting the availability and attractiveness of minimum funding waivers. Also, the Proposal would modify the tax rules to eliminate those provisions which may prevent employers from making additional contributions to remedy the underfunded status of a plan.

C. The current plan termination rules should be modified to improve the likelihood that participants will receive their full accrued benefits and to protect the PBGC.

The Proposal would make it more certain that employers will fund their defined benefit plans adequately. In addition, participants will be more likely to receive their promised benefits after termination of an underfunded plan because the employer's termination liability to participants will be increased. The Proposal would also curtail the ability of employers in certain cases to shift unfunded liabilities to the PBGC by providing for limited transfers of assets from ongoing overfunded plans to terminating underfunded plans.

D. Employers should be permitted on a tax favored basis to use assets available for withdrawal from a defined benefit plan to fund post-employment health benefits for existing retirees.

The Proposal would permit employers to transfer assets available for withdrawal from defined benefit plans to tax-favored welfare benefit trusts for payment of health benefits of existing retirees, without current tax consequences. In addition, the Proposal would repeal Code section 401(h). Assets currently set aside in a 401(h) account could be transferred without tax consequences to a tax-favored retiree health fund.

III. IMPACT OF THE PROPOSAL

The Administration Proposal will serve to better protect the pensions of American workers, safeguard the Treasury, and reduce the financial burdens imposed on the PBGC. In the opinion of the Administration, a fundamental revision of the termination and funding provisions of ERISA is the best means of minimizing the number of underfunded plans and the extent of underfunding in the defined benefit universe. This will avoid, or at least mitigate losses incurred by plan participants and the PBGC. These modifications principally will affect underfunded plans and will have a minimal impact on properly funded plans. In addition, the post-employment health transfer provision will help to ameliorate the growing problem of unfunded retiree health benefits, but will not entail additional tax expenditures.

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I. BACKGROUND

Private pension plans constitute a major and increasingly important source of retirement income for American workers. In general, these plans are subject to the provisions of the Employee Retirement Income Security Act of 1974 (ERISA). One of the primary purposes of ERISA is to assure the adequate funding of defined benefit pension plans. To this end, ERISA imposes minimum funding standards, regulates the investment of plan assets, and strictly limits employer access to such assets. In addition, ERISA established the Pension Benefit Guaranty Corporation (PBGC) to guarantee certain benefits under defined benefit pension plans.

The rules established as part of ERISA (and subsequent amendments thereto) have largely accomplished their intended purpose. However, weaknesses remain that enable employers to act in ways that may jeopardize their ability to fulfill benefit promises they have made. Two particularly troubling trends have developed in connection with defined benefit plans that are either overfunded or underfunded in relation to their benefit obligations.

First, during the recent past, a significant number of employers have terminated their overfunded defined benefit pension plans in order to obtain, through asset reversions, the assets of plans that exceed such plans' termination liability to participants. Plan terminations are costly and disruptive. Even in the case where an employer continues to provide defined benefit plan coverage to its employees following a plan termination and asset reversion, such a transaction reduces participants' benefit security with respect to future benefit accruals and may also discourage the employer from granting ad hoc benefit increases or cost of living allowances for retirees.

Second, in spite of the minimum funding standards imposed by ERISA, many pension plans are currently underfunded to a substantial degree. Indeed, under the provisions of current law, the funding status of a plan may deteriorate even though an employer fully complies with the minimum funding standards and other requirements of ERISA. Compliance with the minimum funding standards does not necessarily assure that, upon a plan termination, participants' benefits will be adequately funded. As a result, participants may not receive their full accrued benefits and the PBGC may be required to accept responsibility for some or all of such benefits.

The Administration believes that public policy should encourage optimal, rather than deficient or excessive, funding of pension obligations. An employer should have neither the incentive nor the opportunity to make pension promises that exceed its own legal liability or financial capacity to keep those promises when they come due. The purpose of sound funding is to protect participants' benefits by insulating them from the business risk of the employer, as well as to protect the PBGC insurance system from systematic loss. In addition, for purposes of both tax policy and economic efficiency, employers should not be required to fund their benefit promises beyond a level that reasonably assures that such benefits will be paid when due.

The Administration's Proposal is designed to improve benefit security for plan participants in several ways. First, employers' access to surplus assets in overfunded defined benefit plans is limited and rationalized; second, the minimum funding standards are strengthened to increase the likelihood that defined benefit plans will be funded sufficiently to provide participants' accrued benefits; and, third, employers are made more responsible and accountable for their benefit promises.

A. Asset Reversions From Overfunded Plans

Under ERISA, employers are required to fund their pension plans in accordance with minimum funding standards. These standards were developed to ensure that employers contribute sufficient assets to fund not only participants' accrued benefits, but also a portion of their projected benefits (i.e., including estimated future salary increases but not estimated future service).

Frequently, defined benefit plans that are funded in accordance with the minimum funding standards accumulate assets in excess of their termination liability to participants. Under ERISA, an employer may recover assets from a plan only if the plan is terminated and the assets of the plan exceed its termination liability. Consequently, many employers have felt compelled to terminate plans in order to gain access to excess plan assets.

Concerned that employers would completely discontinue their defined benefit plans in order to obtain assets in excess of termination liabilities, in May, 1984, the Department of Labor, the Department of the Treasury and the PBGC jointly issued the Asset Reversion Implementation Guidelines (the "Guidelines", see exhibit E). The Guidelines permit employers to gain access to excess assets without completely discontinuing their current defined benefit pension plan arrangements by allowing "termination/reestablishments" (e.g., the termination of an overfunded defined benefit plan followed by the establishment of a new defined benefit plan) and "spinoff/terminations" (e.g., the splitting of one overfunded plan into two plans: a plan with

retirees and excess assets, which is terminated to enable the employer to recover the excess, and an ongoing plan with active employees and assets equal to termination liabilities).

Since the issuance of the Guidelines, many employers have been able, in effect, to "withdraw" assets from their overfunded defined benefit plans without leaving the defined benefit system. While the Guidelines have made it possible for sponsors with significantly overfunded plans to continue to offer defined benefit plans to their employees, they did not address two important problems.

First, an ongoing defined benefit plan with assets in excess of termination liabilities contains an "asset cushion" that protects the plan against adverse investment performance in the future and may be used to fund future benefit accruals and increases. Such an "asset cushion" generally is consistent with the minimum funding standards. Following a termination/reestablishment or a spinoff/termination transaction, the remaining defined benefit plan generally has no such asset cushion.

Second, because the amount of assets available to an employer on plan termination through a reversion is determined on a plan-by-plan basis, it is possible for an employer to remove assets from overfunded plans (typically, plans for salaried employees) while maintaining materially underfunded plans (typically, plans for less highly paid, hourly employees). In such situations, an employer may inappropriately benefit from the tax-favored treatment of assets that are not used to provide retirement benefits and, at the same time, leave some participants with inadequately funded benefits and perhaps shift liabilities to the PBGC.

Given the extent of overfunding in the single employer defined benefit plan system, currently estimated at a net of $218 billion on a termination basis (see exhibits B and C), and the size and number of terminations involving asset reversions, the Administration believes that there is a need for legislative action to redefine the alternatives available to sponsors in obtaining access to assets in overfunded defined benefit plans.

B. Terminations of Underfunded Plans

In recent years, there has been a marked increase in the extent to which large defined benefit plans involved in distress terminations have been underfunded (see exhibit D). These plans have not had sufficient assets to provide participants' accrued benefits and, in many cases, have not had adequate assets to provide even the level of benefits guaranteed by the PBGC. Thus, participants have lost promised benefits and the PBGC has been forced to pick up significant additional liabilities.

The Administration believes that current law does not cope in a rational manner with the problem of underfunding. First, the current minimum funding standards have been proven to be inadequate because the allowed amortization periods for certain increased costs, experience losses and funding waivers are excessive. Second, under present law, employers are not fully responsible for their benefit promises and thus are not bound and determined to fund their defined benefit plans properly. Third, in some cases, the tax laws discourage employers from contributing amounts to remedy underfunding.

C. Retiree Health Benefits

At the same time that there have been larger than expected accumulations of assets in some defined benefit plans, there has been growing concern that many employers will not be able to continue retiree health programs, which are rarely prefunded, at current benefit levels. This concern is especially great for mature firms that have experienced rapid growth in their retiree population.

Although employer-sponsored health insurance for retirees is a relatively new benefit, it is an important one for those who are fortunate enough to receive it. For retirees over age 65, it is an important supplement to Medicare, and for early retirees it is even more important because they generally do not have access either to Medicare or to affordable private individual health insurance. Currently, about 6.9 million retirees and their spouses are receiving employer-sponsored retiree health insurance and an estimated 16 percent of the population over age 65 receives supplemental health coverage through private sector employer-sponsored retiree programs. Permitting employers to use a part of their surplus pension assets to fund health benefits for current retirees is an important element of the Administration's plan to rationalize employer access to and use of surplus assets in overfunded defined benefit plans.

II. PROPOSAL

A. Employer Access to Plan Assets

1. Current Law

Current law requires that pension plan assets be used for the exclusive benefit of plan participants. However, an employer may reserve the right on plan termination to recover plan assets that are in excess of the plan's termination liability to plan participants. A plan's termination liability to participants includes (i) all vested plan benefits and (ii) unvested and contingent plan benefits "to the extent funded," including those for which the eligibility conditions have not been satisfied.

The previously cited Guidelines, etc., allow an employer, if the plan so provides and subject to certain conditions (e.g., the requirement that annuities be purchased) to terminate an overfunded defined benefit plan, recover assets in excess of the plan's termination liability and reestablish a new plan covering the same employees (i.e., a "termination/reestablishment" transaction). The Guidelines also allow an employer to engage in a "spinoff/termination" transaction. In a spinoff/termination transaction, an employer typically splits an overfunded plan into two plans, one covering retirees and containing all assets in excess of termination liabilities and a second plan covering active employees and containing assets sufficient to fund such plan's termination liability only, and then terminates the plan with the excess assets to recover the reversion.

In general, asset reversions (whether or not on account of termination) are subject to the ten percent excise tax and the regular income tax. There is a limited exception, however, for certain reversions transferred to employee stock ownership plans prior to January 1, 1989.

2. Reasons for Change

Typically, a plan remaining or reestablished pursuant to the Guidelines does not have a cushion of assets above the level of the plan's termination liability. The absence of this cushion reduces participants' benefit security with respect to future benefit accruals and may also discourage employers from granting ad hoc benefit increases or cost of living allowances for retirees.

Furthermore, it is not uncommon for an employer to have both an overfunded plan (e.g., for salaried employees) and an underfunded plan (e.g., for hourly employees.) Some employers have received reversions from overfunded plans and then terminated underfunded

plans, thereby depriving some participants of their full accrued benefits and, in some cases, shifting significant liabilities to the PBGC, even though, by receiving a reversion, such employers are at the same time using tax-favored retirement funds for non-retirement purposes. Currently, there is no requirement that the ongoing plans of the employer or controlled group receiving a reversion be funded sufficiently.

3. Explanation of the Proposal

In General. The Proposal permits employers to withdraw assets from ongoing defined benefit plans provided that, following the withdrawal, a sufficient asset cushion remains in the plan and in all other plans maintained by the employer and the controlled group. The Proposal generally limits the amount that an employer may recover from a plan on termination through a reversion to the amount that could have been withdrawn from such plan. However, if the termination causes the employer (and the controlled group) to exit the defined benefit system entirely, the employer may recover all assets in excess of the termination liability of the plan. In such event, the employer would be precluded from reestablishing a defined benefit plan for a period of five years.

Asset Withdrawals. An employer would be permitted to withdraw assets from an ongoing defined benefit plan to the extent that, after the withdrawal, each of the following conditions is satisfied: (A) the value of the assets in the plan from which the withdrawal is made exceeds the "minimum benefit security level" for such plan and (B) the value of the assets in all other plans of the employer and the controlled group of which the employer is a part (excluding the plan from which the withdrawal is made) exceeds the "minimum benefit security level" for all such plans. Appropriate assumptions and methods for valuing termination liability and plan assets would be provided for purposes of these rules.

The "minimum benefit security level" would be equal to the greater of (A) the termination liability of the plan(s) plus 100 percent of the excess of the full funding liability of the plan(s) (calculated under the projected unit credit funding method) over the termination liability of the plan(s), or (B) 125 percent of the termination liability of the plan(s). A reduced cushion would be allowed for any annuitized benefits (e.g., under (A), 40 percent would be substituted for 100 percent and under (B), 110 percent for 125 percent).

In contrast to a plan termination, an asset withdrawal from an ongoing plan would not require full vesting of plan participants' benefits.

Asset Reversions on Plan Termination. Upon termination of a defined benefit plan, an employer would be entitled to an asset reversion equal to the "permissible reversion amount." If, following the termination of the plan, the employer or a member of its controlled group continues to maintain a defined benefit plan, the "permissible reversion amount" would equal the amount that the employer could have withdrawn from the plan. The remaining assets in excess of the plan's termination liability would be transferred to the remaining ongoing plan(s) under appropriate allocation rules. If, following the termination of an overfunded plan, neither the employer nor any member of the controlled group maintains a defined benefit plan, the "permissible reversion amount" would equal the excess of the terminating plan's assets over the plan's termination liability to participants.

Following the termination of an overfunded plan, an employer receiving a reversion and other members of its controlled group generally would be precluded from establishing a defined benefit plan for the same employees for a period of five years. Also,, special rules would be developed to deal with certain changes in the composition of a controlled group, e.g., the acquisition of divisions and subsidiaries maintaining defined benefit plans for their own employees.

The current law rule requiring full vesting (to the extent funded) of accrued benefits under the terminating plan would be retained.

Sponsorship and Asset Transfers. A transfer of plan sponsorship beyond the controlled group of the employer would be treated as a plan termination for purposes of determining the extent to which assets in excess of the plan's termination liability may be transferred with the plan beyond the controlled group. Thus, for example, if plan sponsorship is transferred beyond the controlled group in connection with the sale of a division or subsidiary, assets in excess of the plan's termination liability would be permitted to remain in the plan only to the extent that the employer could have recovered such assets through a termination of the plan and asset reversion. Prior to the transfer of sponsorship, excess assets that would not be available to the employer on plan termination thus would have to be transferred to other defined benefit plans of the employer (or controlled group) under appropriate allocation rules.

Similarly, transfers of excess assets from a defined benefit plan to a defined contribution plan within a controlled group would be permitted only to the extent that such assets could have been withdrawn from the defined benefit plan.

Frequency Limit. After an employer has recovered assets from a plan through either a withdrawal or a reversion, neither the employer nor any member of its controlled group would be permitted to receive plan assets in a subsequent reversion or withdrawal for a period of ten years. (A transfer of excess assets to a defined contribution plan would be treated as a withdrawal or reversion for purposes of this rule.) However, if, through a reversion or withdrawal, an employer recovers less than the total amount available, such employer (or the controlled group) may recover assets in a subsequent reversion or withdrawal within the ten year period provided that the subsequent reversion or withdrawal does not exceed the lesser of (i) the excess of the total amount available at the time of the initial reversion or withdrawal over the actual amount of such reversion or withdrawal, or (ii) the amount available for reversion or withdrawal under the applicable rules at the time of the subsequent reversion.

However, in no case would an employer or controlled group be permitted to recover assets through a withdrawal or reversion on more than three occasions during any ten year period. Also, an employer would be precluded from recovering a withdrawal or reversion from a newly established plan until the plan had been in effect for ten years. However, an employer may, at any time, receive a reversion from a terminating plan if, following such reversion, neither the employer nor any member of the controlled group continued to maintain a defined benefit plan. Simultaneous recoveries from more than one plan within a controlled group would count as a single recovery for purposes of the application of the frequency limit.

Special frequency rules would be applied to deal with sales and purchases of divisions and subsidiaries with defined benefit plans and with changes in the composition of a controlled group. For example, it generally would be appropriate to exempt an employer (and controlled group) from the ten year frequency limit if it is departing entirely from the defined benefit system.

Taxation of Withdrawals and Reversions. All withdrawals and reversions would be subject to the ten percent excise tax and income tax. Similarly, all excess assets transferred from a defined benefit plan to a defined contribution plan within the same controlled group and all defined benefit plan assets transferred to a new sponsor in excess of the transferred plan's termination liability would be treated as though they were recovered by the transferring employer. Thus, such assets would be subject to the ten percent excise tax and regular income tax. Asset transfers between defined benefit plans maintained by members of the controlled group would be exempt from the excise tax and income tax.

Collectively Bargained Plans. The reversion, withdrawal and transfer rules would apply to single employer collectively bargained plans. Except in the case of determining whether an employer has exited the defined benefit system and in certain other limited cases, such rules generally would not apply to multiemployer plans.

B. Insufficiently Funded Plans

1. Minimum Funding Standards

a. Current Law

An employer that maintains a defined benefit plan is required to fund the plan in accordance with the minimum funding standards of ERISA. The minimum funding standards require that an employer contribute an annual amount sufficient to fund a portion of participants' projected benefits determined in accordance with one of several prescribed funding methods, using actuarial assumptions that are reasonable in the aggregate.

The annual amount required to be contributed under the minimum funding rules consists of two components: normal cost (i.e., a charge relating to the current year of service) and a portion of the plan's unfunded accrued liabilities (i.e., all charges other than normal costs). The portion of a plan's unfunded accrued liabilities that must be contributed for a year is determined by amortizing such liabilities as follows: amortization of unfunded past service liability existing before January 1, 1974 over 40 years; amortization of unfunded past service benefit increases created after January 1, 1974 over 30 years; and amortization of net experience losses over 15 years.

The total annual contribution must be paid to the plan no later than 2-1/2 months after the close of the year to which the contribution relates. (Treasury regulations generally have extended this due date by six months.) An employer that fails to contribute the amount required under the minimum funding standards is subject to a five percent excise tax.

If an employer is able to demonstrate that the required minimum funding contribution for a year would impose a substantial business hardship, the employer may request a minimum funding waiver from the Internal Revenue Service. Once an employer has secured a funding waiver, it must amortize the waived amount over a period of 15 years. Interest on the waived amount is equal to the rate applicable under Code section 6621(b) (i.e., the interest rate applicable to late payment of taxes).

Contributions to defined benefit plans are deductible to the extent provided in Code section 404. Contributions that are not deductible are subject to a ten percent excise tax.

b. Reasons for Change

The current minimum funding rules do not adequately assure that plans will have enough assets to pay participants' benefits when they become due. In addition, the current rules do not relate the pace of required funding to a plan's funded status or the maturities of a plan's liabilities. As a result, unfunded liabilities can build to levels that threaten the benefit security of plan participants and produce potentially large claims against the PBGC insurance program. The problem occurs mainly in plans with mature populations, large past service credits, large experience losses, substantial recent benefit increases or nonpayment of required contributions.

Finally, because the tax law prohibits deductions for certain contributions to underfunded plans and imposes a ten percent excise tax on nondeductible contributions, some employers are discouraged from improving the funded status of their underfunded plans.

c. Explanation of the Proposal

In General. The Proposal is primarily directed at improving the funded status of plans that are underfunded on a termination basis. Such plans would be subject to the following requirements: (i) more rapid amortization of certain unfunded accrued liabilities and waived contributions; (ii) rapid amortization of future declines in such a plan's funded status; and (iii) a minimum funding contribution for a year at least equal to the distributions made during the year (including administrative and investment expenses). In addition, the Proposal would improve the funding of all defined benefit plans by (a) making all members of the controlled group including the plan sponsor liable for the minimum funding contribution; (b) accelerating the due date for minimum funding contributions; and (c) limiting the availability and attractiveness of minimum funding waivers. Also, the Propcsal would modify the tax rules that may discourage employers from making additional contributions to remedy the underfunded status of plans. None of these modifications would alter application of the current law full funding limit. In addition, special adjustments to these rules would be provided for plans using a spread gain actuarial method (e.g., the aggregate funding method). Finally, the special problems created by certain types of contingent benefits, such as shutdown benefits, should be considered.

Funded Ratio. Special minimum funding rules would apply to a defined benefit plan with a "Funded Ratio" of less than 100 percent. A plan's "Funded Ratio" is equal to the percentage determined by dividing the actuarial value of the plan's assets by 110 percent of the plan's termination liability to participants (calculated by using the plan's funding assumptions). For purposes of this calculation and application of the following rules, a plan's termination liability would include all fixed and contingent accrued benefits that would be provided if the plan had sufficient assets. Appropriate adjustments would be made for contributory defined benefit plans.

Existing Unfunded Accrued Liability. The Proposal would revise the amortization period for a plan's unfunded accrued liability existing on the effective date of this rule. The amortization period for any particular plan would range from a minimum of three to five years to the number of years remaining under the plan's existing amortization bases, depending on the plan's Funded Ratio and the maturity of the plan's liabilities. The applicable amortization period for a plan would be directly related to the plan's Funded Ratio, so that the higher the plan's Funded Ratio the longer the amortization period. The maturity of a plan's liabilities would represent the extent to which the plan's total projected liabilities (including past and future service benefits) are attributable to past service liabilities (determined under the plan's actuarial method). Generally, the older the plan participants and the more benefits are attributable to past service, the greater the maturity of the plan's liabilities and the shorter the applicable amortization period. It is expected that the amortization periods for many of the plans subject to this rule would not be shortened.

The determination of the applicable amortization period for a plan's existing unfunded liability would be made either by direct application of a prescribed formula or by reference to a table that would be developed to show the applicable amortization periods. Special rules will be developed to modify the treatment of certain plans in cases where required contributions under these rules would exceed reasonable limits or would create disparities in the treatment of less funded and better funded plans.

Benefit Increases. The applicable amortization period for accrued liabilities created by future benefit increases, expanded coverage, or the creation of a new plan would be determined in the same fashion as the period for existing unfunded accrued liabilities. For this purpose, the Funded Ratio of the plan would be determined immediately after the benefit increase.

Waived Contributions. The maximum amortization period for future waivers of minimum funding contributions would be the period

determined by multiplying 15 years by the plan's Funded Ratio, but in no case more than 15 years. For example, the amortization period for a plan that has a Funded Ratio of 40 percent is 15 years times 40 percent, or 6 years.

Funded Ratio Maintenance Rule. If a plan's Funded Ratio falls below 100 percent or is less than 100 percent and declines further, a funded ratio maintenance amortization base would be created under the minimum funding rules. The base would be computed by multiplying the plan's termination liability after the decline in the Funded Ratio by the amount of the decline in the ratio (or, if less, the amount of the excess of 100 percent over the plan's Funded Ratio after the decline) and is to be amortized over three years (or, in the case of benefit increases under plans with higher funded ratios, over a longer period). For example, assume that a plan's termination liability is $1,000,000 and its Funded Ratio declines from 70 percent to 60 percent. The funded ratio maintenance base for this plan would be $1,000,000 times 10 percent, or $100,000; such base would be amortized over three years.

The amortization bases for benefit increases and experience losses would be adjusted to avoid duplicative amortizations.

Cash Flow Rule. If a plan's Funded Ratio is less than 100 percent, the minimum required contribution for a year would be at least an amount equal to the total distributions (including administrative and investment expenses) paid by the plan during such year. However, in no case would the contribution required under this cash flow rule cause a plan's funded ratio to exceed 100 percent. In addition, in the case of certain plans, e.g., frozen or retiree-only plans, there would be special rules limiting the contribution otherwise required under this provision.

Controlled Group Liability. The employer and each member of its controlled group would be jointly and severally liable under the minimum funding rules with respect to each ongoing defined benefit plan. (Of course, it is contemplated that certain minority shareholders of a controlled group member that is required to make a minimum funding contribution to a plan maintained by another member of the controlled group may arrange to be reimbursed or compensated through an agreement with the other members of the controlled group.) The deduction rules would be modified as appropriate to allow controlled group members to deduct contributions made to plans maintained by other members of the same controlled group.

Contribution Due Date. An employer (and controlled group) would be required to make minimum funding contributions for a year on a

quarterly basis (analogous to the estimated tax rules). The total required contribution for a year would have to be made within 2-1/2 months after the close of the plan year. Failure to make a contribution by the applicable due date would result in application of the five percent excise tax.

Minimum Funding Waivers. An employer would be required to file a funding waiver application with respect to a plan year within 2-1/2 months after the close of the plan year. The standards for determining whether an employer is facing a substantial business hardship would be clarified so that it is clear that funding waivers are limited to temporary hardship cases; the burden would be placed on the employer to demonstrate hardship and to prove that the hardship is temporary. Because all members of the controlled group containing the plan sponsor would be liable under the minimum funding rules, hardship determinations would be based upon the circumstances of the entire controlled group, rather than merely the circumstances of the employer maintaining the plan.

The interest rate required on waived contributions would be increased to the greater of the plan rate or the market rate for loans to distressed companies (e.g., a rate based on a B bond rating by Standard and Poors, or an equivalent rating by another rating service). To protect plans against protracted periods of serious underfunding and against serious deterioration of their funded statuses, the number of annual waivers that could be granted with respect to any plan within a fifteen year period would be reduced from five to three. To assure that participants are aware of the potential loss of contributions to the plan, employers would be required to notify plan participants and beneficiaries of any funding waiver application and to provide them with an opportunity to comment. Finally, additional restrictions on funding waivers, designed to ensure that they are granted only when absolutely necessary, should be considered.

Deduction Limits. The deduction limits would be revised to allow a deduction for a defined benefit plan contribution in excess of the otherwise applicable deduction limits to the extent that such contribution does not cause either the plan's assets to exceed the plan's termination liability or the assets in all plans of the controlled group to exceed the total termination liability of the controlled group's plans. This modification would also have the effect of waiving the ten percent excise tax on such contributions. Finally, appropriate rules would be developed to prevent use of the new minimum funding rules to gain inappropriate deductions.

2. Plan Investment in Employer Securities

a. Current Law

An employee benefit plan may acquire and hold securities issued by the plan sponsor only if such securities are "qualifying" employer securities. In general, any employer stock is treated as a qualifying employer security, but debt obligations of the plan sponsor are treated as qualifying only if they are "marketable obligations" (i.e., debt obligations which are part of an issue a substantial portion of which is sold to investors who are independent of the sponsoring employer). Most plans, including defined benefit plans, are subject to an additional rule under which the plan may not acquire qualifying employer securities in an amount in excess of ten percent of plan assets. These rules are intended to limit the risks to which a plan would be exposed through investments in the plan sponsor. Most individual account (defined contribution) plans, however, may qualify as "eligible individual account plans." These plans may invest up to 100 percent of their assets in qualifying employer securities.

b. Reasons for Change

Many employers have issued stock to their employee benefit plans that has features that are substantially different from stock issued by the employer to other investors. In many cases, these special classes of stock are similar to debt obligations. Proper valuation of such stock is difficult, especially in the case of closely held corporations. Because the current law ownership tests applicable to marketable debt obligations do not apply to employer stock, there are no independent safeguards with respect to such valuations. In addition, because these special classes of stock may never have been subject to a "market test" (i.e., confirmation of valuation by means of investments by independent interests) and can be held exclusively by the plan, plan investment in such stock may involve increased risks to plan participants and the PBGC.

In addition, some employers maintain "floor-offset" arrangements that combine defined benefit and defined contribution plan features. Under such arrangements, a participant's benefit under the defined benefit portion of the arrangement is reduced by the benefit provided to such participant under the defined contribution portion of the arrangement. Many employers take the position that the defined contribution portion of the arrangement is an eligible individual account plan and argue that all, or substantially all, of the participants' individual accounts may be invested in employer securities. However, in such situations, the security of the participants' defined benefit promise is

substantially weakened and the risk of loss to the PBGC is greatly increased.

Although the Internal Revenue Service has ruled that floor-offset arrangements may meet the qualification requirements of the Internal Revenue Code, the Department of Labor has not ruled that the individual account portions of these arrangements qualify for the eligible individual account plan exemption from the percentage limitations on acquisitions of qualifying employer securities.

c. Explanation of the Proposal

In General. The Proposal would tighten and clarify provisions in the law governing plar investment in employer securities.

Plan Investment in Employer Securities. The rules governing the investment of plan assets in employer securities would be modified by extending to employer stock the current law ownership limits applicable to marketable obligations under ERISA section 407(e)(2). The current law provisions relating to employer stock investments by eligible individual account plans would be retained (i.e., eligible individual account plans would be permitted to invest in any class of employer stock).

Application of the rules limiting the acquisition and holding of employer securities and employer real property (ERISA section 407) would be clarified and modified with respect to floor-offset arrangements as follows: (i) the individual account portion of a floor-offset arrangement would be subject to the ten percent limitation with respect to acquisitions of qualifying employer securities or qualifying employer real property; and (ii) existing investments in qualifying employer securities or qualifying employer real property by the individual account portion of a floor-offset arrangement in excess of ten percent of plan assets would be permitted for a specified period under rules similar to those in section 407(a) of ERISA.

3. Terminations of Underfunded Plans

a. Current Law

If a terminating defined benefit plan has assets that are insufficient to cover its termination liability, the employer may terminate the plan without any continuing legal obligation to provide participants' unfunded accrued benefits, provided that the plan has sufficient assets to cover its "benefit commitments." Benefit commitments generally refer to all vested, accrued pension benefits for which all eligibility conditions have been satisfied as of the date of termination.

If the terminated plan has assets that are insufficient to fund benefit commitments, the plan may be terminated voluntarily only in a distress termination (i.e., the employer must be in financial distress). In such a case, the employer is liable to a termination trust maintained for the benefit of the participants for the lesser of 75 percent of the unfunded benefit commitments or 15 percent of the total unfunded and funded benefit commitments. The priority status of the claim of such a termination trust is determined under generally applicable bankruptcy principles. The law requires that payments to the trust be in accordance with negotiated terms. Any amounts collected with respect to this claim are distributed to participants as collected, after payment of the trust's administrative expenses, without regard to the normal allocation priorities of ERISA.

If a terminating plan does not have assets sufficient to fund "PBGC guaranteed benefits," the employer is liable to the PBGC for the greater of (i) 100 percent of the unfunded PBGC guaranteed benefits, up to 30 percent of the employer's (and controlled group's) net worth, or (ii) 75 percent of the unfunded PBGC guaranteed benefits. The former claim of the PBGC has the status of a Federal tax lien for bankruptcy purposes; the priority status of the latter claim is determined under generally applicable bankruptcy rules. In addition, the PBGC is required to negotiate terms for payment of the claims over an extended period of time.

These rules apply to the termination of an underfunded defined benefit plan without regard to whether, at the time of termination, the employer (or controlled group) also maintains one or more overfunded plans.

b. Reasons for Change

The current rules applicable to an employer terminating an underfunded defined benefit plan do not impose a continuing liability on the employer for the plan's unfunded termination liability to participants, provided that the plan has sufficient assets to fund benefit commitments. Moreover, though a plan may have insufficient assets upon termination to satisfy benefit commitments, the employer is not necessarily liable to participants or the PBGC for the full funding shortfall. As a result of these rules, employers have little incentive to fund a plan beyond the level of benefit commitments. This in turn makes it more likely that participants will not receive their full promised pension benefits and that the PBGC will have to provide unfunded guaranteed benefits.

c. Explanation of the Proposal

In General. The Proposal would improve the likelihood that employers will adequately fund their defined benefit plans and that participants will receive their promised benefits after termination of an underfunded plan by making an employer's termination liability to participants equal to the plan's termination liability to participants. (This is consistent with the FASB rules requiring an employer to account for plan liabilities.) In addition, the Proposal would reduce the extent to which an employer may improperly shift unfunded benefit liabilities to the PBGC. The Proposal also would reduce the incidence of such terminations by providing for limited transfers of assets from ongoing overfunded plans to terminating underfunded plans.

Employer's Termination Liability. The required plan asset level for a standard termination would be increased from the current law requirement of "benefit commitments" to the full level of the plan's termination liability to participants. For this purpose, the plan's termination liability would include all fixed and contingent accrued benefits that would be provided if the plan had sufficient assets.

A defined benefit plan with assets insufficient to provide its termination liability to participants would be unable to terminate unless the employer (and controlled group) could satisfy the criteria for a distress termination. In a distress termination, the employer's (and controlled group's) liability would be increased from the current law percentage of benefit commitments to the full amount of the plan's unfunded termination liability to participants. (This would not change the priority status of the persion claims in bankruptcy.) Assets collected to satisfy the employer's liability would be allocated in accordance with the current law allocation rules, except that the value of PBGC's claim for 30 percent of net worth would be allocated exclusively to unfunded guaranteed benefits.

Termination of Underfunded Plans. If a plan terminates with assets less than the plan's termination liability, assets would have to be transferred from other plans of the controlled group to the terminating plan, under appropriate allocation rules, to the extent necessary to cover the termination liability of the terminating plan. However, assets may not be transferred from an ongoing plan to the terminating plan to the extent that the transfer would reduce the assets in the ongoing plan to less than the termination liability of such plan. A transfer of a plan with assets less than its termination liability to a sponsor outside of the controlled group would be treated as a termination of the transferred plan for purposes of this rule. (Special provisions would be developed to take into account the relative

benefit levels of the underfunded and overfunded plans and to protect against manipulation of this rule through benefit increases.)

Plan Reestablishments. Except to the extent permitted by the PBGC, an employer (and its controlled group) would be precluded from establishing retirement programs which, in whole or in part, provide substantially similar benefits within five years after termination of a plan that did not have adequate assets to provide PBGC guaranteed benefits.

C. Retiree Health Benefits

1. Current Law

Employers may provide limited tax-favored funding for retiree health benefits using one of two vehicles: (i) a trust established under Code section 401(h), or (ii) a welfare benefit fund described in Code section 419.

A trust established under section 401(h) of the Code must be established incidental to a pension plan and the retiree health benefits provided thereunder must be subordinate to the pension benefits provided by the plan. Contributions to a 401(h) trust established in conjunction with a pension plan are limited to 25 percent of pension contributions and are subject to the overall limits of benefits and contributions under section 415 of the Code. Income on reserves set aside under section 401(h) is exempt from taxation.

Funds for retiree health benefits may also be set aside in a welfare benefit fund described in Code section 419. An employer may make annual deductible contributions to a fund for retiree health benefits. The maximum amount of such contributions is based on the average remaining working lives of the employees and is actuarially determined using assumptions that are reasonable in the aggregate and subject to the constraint that future benefits must be determined on the basis of current medical costs. However, income on assets set aside in a welfare benefit fund for retiree health benefits are treated as unrelated business income of the fund subject to tax.

2. Reasons for Change

Very few employers have set aside funds for health benefits for current retired employees or retiree health benefits for current active employees. As a result, most active and retired employees have little assurance that they will receive, or will continue to receive, retiree health benefits from their employers.

Favorable treatment of transfers of defined benefit plan assets to retiree health funds may induce some employers, who are permitted to withdraw assets from their defined benefit plans, to transfer such assets to retiree health funds to help fund a part of the cost of health benefits for current retirees. Such transfers would increase the security of these benefits for current retirees and, at the same time, would offer employers increased flexibility with respect to the use of excess defined benefit plan assets.

3. Explanation of the Proposal

In General. The Proposal would permit employers to transfer defined benefit plan assets available for withdrawal to a tax-favored health fund for current retirees without current tax consequences. In addition, the Proposal would repeal Code section 401(h); assets currently set aside in a 401(h) account could be transferred without tax consequences to a tax-favored retiree health fund.

Transfers to Retiree Health Funds. An employer would be permitted to transfer all or a portion of the assets available for withdrawal from a defined benefit plan to a retiree health welfare benefit fund to provide health benefits to current retirees. Such a transfer would not be subject to the 10 percent excise tax on asset withdrawals and reversions and would be exempt from current income tax. However, such a transfer would be counted as a withdrawal for purposes of the frequency limit on withdrawals and reversions.

Defined benefit plan assets that are transferred to a retiree health fund would be subject to various restrictions. First, the transferred assets could only be used to provide health benefits to employees who had retired and were covered by an employer-maintained health plan at the time of the transfer. Second, the transferred assets would not be permitted to exceed the present value of the employer's liability for health benefits for such current retired employees. Appropriate rules for calculating such present value would be developed to prevent inappropriate overfunding of the retiree health fund. Special rules would also assure that an employer's current law liability to provide a particular type or level of retiree health benefits is not altered by such a transfer.

Income on assets transferred under this rule to a retiree health fund would be exempt from both income tax and unrelated business income tax if such assets are held in a segregated welfare benefit fund to which no other amounts are added (other than transfers of 401(h) assets).

Elimination of 401(h) Accounts. Accounts maintained under Code section 401(h) would be eliminated. Thus, tax-favored employer funding of retiree health benefits would be permissible only under welfare benefit funds in accordance with the rules of Code section 419. Existing assets in 401(h) accounts could be transferred without adverse tax consequences, however, to a retiree health fund of the type to which excess defined benefit plan assets may be transferred, including a retiree health fund to which such excess assets have been transferred. Such transferred 401(h) assets would be subject to the same rules applicable to transferred defined benefit plan assets.

D. Effective Dates and Transition Rules.

The new rules included in the Proposal generally would be effective for years beginning after December 31, 1987. In order to prevent transactions which would be entered into in anticipation of the adoption of the Proposal, certain rules will be effective earlier (e.g., the rules limiting the assets available to an employer upon a plan termination through a reversion and the rules relating to plan investments in employer securities). Where appropriate, transition rules will be developed.

EXHIBIT A

SUMMARY OF ASSET REVERSION CASES, 1980-1986

Year	Number of Plans	Number of Participants	Reversions (in millions)
1980	9	22,242	$ 18.4
1981	35	30,512	159.0
1982	83	124,321	407.5
1983	162	165,005	1,579.2
1984	330	386,380	3,513.2
1985	525	686,969	6,171.4
Total	1,144	1,415,429	$ 11,848.7

Notes: Only includes plan terminations (including pending cases) with a reversion of $1 million or more. Numbers of participants are not adjusted to include ongoing plan participants in spinoff-terminations.

Source: PBGC Case Processing System and Case Files (1980-1985).

EXTENT OF OVERFUNDING IN SINGLE-EMPLOYER DEFINED BENEFIT PLANS
(Dollars in billions)

	12/31/83	12/31/84	12/31/85	7/10/86	12/31/86
ASSETS	$560	$607	$759	$878	$876
LIABILITIES	$415	$450	$520	$627	$658
FUNDING RATIO	1.35	1.35	1.46	1.40	1.33
EXCESS ASSETS	$145	$157	$239	$251	$218
PBGC RATE	9.5%	10.0%	9.0%	7.5%	7.5%

NOTE: Liabilities were adjusted by 7.7% for each 1 percentage point change between the PBGC interest rate and the plan interest rate. 1983 are actual numbers based on Form 5500 Series data. Data for 1984 and later years are estimates.

EXHIBIT B

EXHIBIT C

Estimated Underfunding and Overfunding of Single-Employer Defined Benefit Plans By Industry, 1986
(millions of dollars)

A. All Industries	Unfunded Liabilities in Underfunded Plans	Excess Assets in Overfunded Plans	Net Excess Assets
Agriculture	$ 92	$ 1,063	$ 971
Mining	288	4,980	4,692
Construction	111	1,735	1,624
Manufacturing	36,947	137,415	100,468
Transportation	2,667	9,652	6,985
Communications and Utilities	2,713	23,605	20,892
Wholesale and Retail Trade	612	11,386	10,774
Finance, Insurance and Real Estate	670	38,825	38,155
Services	527	19,976	19,449
Tax-Exempt organizations	534	8,427	7,893
Industry unknown	169	6,266	6,097
Total	$45,330	$263,330	$218,000
B. Manufacturing Industry			
Food	$ 928	$ 9,193	$ 8,265
Textiles and Apparel	269	3,350	3,081
Lumber and Paper	816	5,994	5,178
Printing	199	5,376	5,177
Chemicals	391	18,492	18,101
Petroleum	650	15,131	14,481
Rubber	1,899	2,250	351
Leather	94	309	215
Stone	1,165	2,656	1,491
Primary metals	10,079	4,047	-6,032
Fabricated metals	2,374	7,384	5,010
Machinery	3,298	35,184	31,886
Trans. equipment	14,267	18,634	4,367
Measuring instruments	518	9,415	8,897
Total	$36,947	$137,415	$100,468

Source: DOL/PWBA Office of Research and Economic Analysis. Estimates are for December 31, 1986.

EXHIBIT D

SUMMARY OF INSUFFICIENT PLAN TERMINATIONS GUARANTEED BY THE PBGC
1974 TO 1986
(Dollars in millions)

DATE OF TERMINATION	NUMBER OF PLANS	GUARANTEED BENEFIT LIABILITY	PLAN ASSETS	TOTAL FUNDING INSUFFICIENCY	AGGREGATE FUNDING RATIO	AVERAGE INSUFFICIENCY PER PLAN ($ in 000'S)
7/1/74 to 6/30/75	98	55.8	19.4	36.4	0.35	371
7/1/75 to 9/30/76	172	88.4	44.3	44.1	0.50	256
10/1/76 to 9/30/77	129	51.8	21.0	30.8	0.41	239
10/1/77 to 9/30/78	100	124.6	45.6	79.0	0.37	790
10/1/78 to 9/30/79	81	81.5	32.4	49.1	0.40	606
10/1/79 to 9/30/80	106	180.1	81.8	98.3	0.45	927
10/1/80 to 9/30/81	132	165.8	71.2	94.6	0.43	717
10/1/81 to 9/30/82	126	438.7	174.2	264.5	0.40	2,099
10/1/82 to 9/30/83	124	441.7	226.1	215.6	0.51	1,739
10/1/83 to 9/30/84	84	62.9	24.1	38.8	0.38	462
10/1/84 to 9/30/85	39	265.1	74.9	190.2	0.28	4,877
TOTAL	1,191	1,956.4	815.0	1,141.4		

EXHIBIT E

ASSET REVERSION IMPLEMENTATION GUIDELINES ISSUED IN MAY 1984

The following has been adopted by the Department of the Treasury, the Department of Labor and the Pension Benefit Guaranty Corporation to provide guidelines for processing defined benefit pension plan terminations involving asset reversions to the plan sponsor.

1. In accordance with current law, when an employer terminates a defined benefit pension plan, it may not recover any surplus assets until it has fully vested all participants' benefits and has purchased and distributed annuity contracts, to protect participants against the risk that their accrued benefits may be jeopardized by future market fluctuations or other factors.

2. At present, upon plan termination, employers can make lump sum payments to certain participants. In some cases, these lump sums have been calculated on the basis of interest rates that are higher than those available to individuals, thereby reducing the value of those benefits. This problem must be addressed. If employees are offered lump sum payments in lieu of future pensions, the amount of the lump sum must fairly reflect the value of the pension to the individual. The Pension Benefit Guaranty Corporation is developing guidelines for determining appropriate lump sum values.

3. An employer that terminates a sufficient defined benefit pension plan may establish a new defined benefit plan covering the same group of employees. The new plan may grant past service credit for the period during which an employee was covered by the terminated plan (subject to the limitations of Section 415 of the Internal Revenue Code). The prior plan and the new plan, in combination, may provide benefits for each participant equivalent to those to which the participant would have been entitled if the prior plan had continued without interruption. The PBGC will clarify the fact that a successor plan is exempt from the five year phase-in of benefit guarantees that applies to newly established plans. The above is one example of what will be deemed a successor plan by the PBGC.

4. In the case of a so-called "spin-off/termination", generally no termination will be recognized and any attempt to recover surplus assets will be treated as a diversion of assets for a purpose other than the exclusive benefit of employees and beneficiaries unless the following conditions are satisfied:

* The benefits of all employees (including those covered by the ongoing plan) must be fully vested and non-forfeitable as of the date of termination.

* All benefits accrued as of the date of termination in the ongoing plan must be provided for by the purchase of annuity contracts which represent irrevocable commitments for the benefit of each individual participant.

* All employees who were covered by the original plan must be given advance notice of the transaction in similar time and manner as if the entire original plan were being terminated.

5. In the case of a so-called "spin-off/termination" and a so-called "termination/re-establishment" transaction, generally any attempt to recover surplus assets will be treated as a diversion of assets for a purpose other than the exclusive benefit of employees and beneficiaries unless the following conditions are satisfied:

(a) In the case of an ongoing plan described in number 4 above, the funding method for the ongoing plan must be changed on the date of termination by combining and off-setting amortization bases in accordance with §412(b)(4) of the Code. The amortization period for this base will be the lesser of the combined amortization period and the weighted average future remaining working lifetime of all covered employees. The employer must request and obtain IRS approval for this change in funding method.

(b) In the case of a new plan established with credit for past service as described in number 3 above, in order to obtain a reversion of surplus assets from the terminated plan, the future amortization period for the unfunded past service liability for the new plan, under Section 412 of the Code, will be the lesser of 30 years and the weighted average future remaining working lifetime of all covered employees. The employer must request and obtain IRS approval for this change in funding method for the new plan.

The agencies' analysis indicates that, in spinoff/terminations where the conditions in numbers 4 and 5a are satisfied, the security of participants' benefits is protected by the purchase and distribution of annuities, the statutory minimum funding rules, including the rules described in number 5(a), and PBGC insurance coverage.

6. Employers are reminded that one of the requirements for plan qualification is that the plan be intended to be permanent. In any case, the funding rules generally require that plan funding be on a going-concern basis rather than on a termination basis. Thus, the tax consequences of multiple "termination/re-establishments" or "spin-off/terminations" are unaffected by these guidelines and will be determined without regard to whether the specific guidelines described above are satisfied with regard to each of the transactions. Generally, an employer may not engage in either a termination/re-establishment or spin-off/termination transaction, involving reversion of assets, any earlier than 15 years following any such transaction.

7. The federal income tax consequences of the receipt of reversions, of deductions for contributions to ongoing or successor plans and of the funding of such plans, after the change in funding method, are unaffected by these guidelines.

8. The PBGC will continue to process and the IRS will now proceed to process all pending termination cases.

Chairman PICKLE. The Chair will ask the subcommittee to come to order and our guests to please take their seats.

At our hearing today, we will be taking our first look at the administration's proposal to reform the funding and termination of defined benefit plans. This review is enormously important because of the vital role our private pension system plays in meeting our national goal of universal retirement security.

In total, our Nation's private pension system has assets of nearly $2 trillion. These private pension plans have assets that nearly exceed our Federal debt. Their assets equal 50 percent of our gross national product.

These funds represent over half of the Nation's available investment capital. No matter how you look at these funds, they are enormous, and the biggest single part of them is the defined benefit system. Almost 30 million workers are covered by over 110,000 single-employer defined benefit pension plans.

However, as large and as successful as the defined benefit system has been, it is now facing very serious problems. Nearly 25 percent of the single-employer plans are underfunded to some extent. The total unfunded liability of underfunded plans exceeds $45 billion. The Pension Benefit Guaranty Corporation already has a deficit of over $4 billion, and there is no end in sight.

Last June the Subcommittee on Oversight held hearings focusing on the underfunding of single-employer private pension plans and its effect on the vitality of the Federal pension plan insurance program. At the conclusion of those hearings, I asked for the administration to give this committee specific recommendations on how we should respond to the funding crisis facing the single-employer pension insurance program.

The past remedy of simply raising the annual premium is not enough. We raised the premium last session from $2.60 to $8.50, and if we were going to follow that approach today, we would have to raise it to over $40.

The administration will respond to our request that we take a new approach to the problem of the defined benefit pension system and will present to this committee its proposal to reform the rules regarding the funding and termination of defined benefit plans. I am eager to hear the testimony of the administration witnesses and appreciate their diligence in responding to the very real problems outlined by the committee.

Also, at our last hearing I said that it seems to me that the welfare of the participants and the program itself would require that some drastic changes be made. In reviewing the administration's proposal, I have noted some provisions that I expect will be pretty controversial. But when the unfunded liabilities of underfunded pension plans exceed $45 billion, and when the deficit of the PBGC exceeds $4 billion, then it is high time for us to quit just whistling a happy tune and hoping that some good fairy will make our troubles go away.

It is my view that the administration has made a very serious proposal in responding to a very serious problem. I hope to hold a series of hearings as we consider these program reforms, and I look forward to working with the employers, the employees, the admin-

istration, and with the other committees of the Congress that have jurisdiction over this issue.

It would seem to me that creating a well-funded pension system that insures the responsible benefit commitments of employers ought not to be beyond our collective ability, and we ought to work together to try to find some answers to the underfunded and overfunded problem.

Before we proceed with the witnesses, I want to see if Mr. Thomas would want to make a preliminary statement or an opening statement.

Mr. THOMAS. Thank you, Mr. Chairman.

I want to join you in welcoming the administration. I think defined benefit pension plans are, on the surface, attractive because they give you certainty. You avoid the potential fluctuations and uncertainties that accompany profit-sharing plans or defined contribution plans.

But the real fear of the defined benefit pension plans is that some are overfunded and some are underfunded. Withdrawals from the overfunded need to have some kind of structure with appropriate conditions for removing the moneys. Then, of course, the underfunded plans wind up becoming burdens on the Pension Benefit Guaranty Corporation and imperil its financial stability.

It is a problem that we are going to be facing in a number of other areas. It is complex, but it is critical. I applaud the administration's leadership in this area and look forward to the proposals that will be presented.

Thank you, Mr. Chairman.

Chairman PICKLE. Our first witness, then, will be the Honorable Roger Mentz, Assistant Secretary for Tax Policy for the Treasury. Mr. Mentz has been kind enough to give us an advance copy, and I personally want to recognize the initiative that the administration is showing in trying to come up with some proposals.

So, Mr. Secretary, I hope we can proceed. You have a rather lengthy statement, and you may stick with your script. I want you to have such time as you think you need to lay out your proposal or your analysis.

Then I would like the other groups, the IRS and the Labor and the PBGC, to give us a general summation of their position or the problem as they see it. I don't want to restrict any of you to time. We are not in that big a hurry. But we would like for you to be able to kind of condense some of it so we can get at some of the questions, and I want all the testimony put on the record.

So, Mr. Secretary, why don't you proceed now? After, say, 15 minutes we may give you a signal, but at least we will proceed. Is that agreeable?

STATEMENT OF HON. J. ROGER MENTZ, ASSISTANT SECRETARY FOR TAX POLICY, U.S. DEPARTMENT OF THE TREASURY

Mr. MENTZ. That is fine, Mr. Chairman.

Chairman PICKLE. All right.

Mr. MENTZ. Thank you and good morning. Good morning, Mr. Thomas. It is a pleasure to be here.

We certainly agree with you that there are some serious problems involving defined benefit pension plans, and we hope you agree that our proposal is a responsible approach to those problems. Private pension plans, as you indicated, are an important source of retirement income for many American people, and the administration believes that recent trends demonstrate the need to provide additional protection for employees' benefits.

It is my privilege to have with me this morning Dennis Kass, on my right, the Assistant Secretary of the Department of Labor; and to Dennis' right, Dr. Kathleen Utgoff, who is the Executive Director of the PBGC; and to my left, William Posner, who is Assistant Director of the Employee Plans Technical and Actuarial Division of the IRS.

I think you recognize that this proposal represents one that has been worked out in close cooperation among the agencies represented here this morning.

Employer-maintained pension plans are subject to the provisions of ERISA. As you know, one of the main purposes of ERISA is to assure the security of benefit promises made to employees under defined benefit plans. The rules of ERISA have largely accomplished their intended purposes. However, two disquieting trends related to defined benefit plans have led the administration to conclude that certain weaknesses in current law permit employers to act in ways that could diminish the security of employees' benefits and lead to increased financial burdens on the PBGC.

I will start with asset reversions. In recent years, a significant number of employers have terminated overfunded defined benefit plans to recover assets in excess of the plan's termination liability. Termination liability is basically the earned benefits at the date of termination.

Since May of 1980, the asset reversions involved in completed and pending plan terminations total about $16 billion. That is about 45 percent of the total assets in those plans and about 2 percent of total assets in all defined benefit plans.

Current law permits these asset reversions even though the employers continue to cover the affected employees in ongoing defined benefit plans. By enabling employers to access all assets in excess of the employees' benefits earned to date—in other words, termination liability—such reversion transactions may erode the protection afforded by the current funding rules, thus potentially diminishing the security of employees' benefits for future benefit accruals. In short, under today's system, it is possible to have a termination reestablishment and a cut back of funds in an ongoing plan that leaves future benefits on a shakier basis.

In addition, current law permits an employer to undertake a reversion transaction with respect to a defined benefit plan even though the employer also maintains another seriously underfunded defined benefit plan that, in a subsequent termination, may be unable to provide employees with their full promised benefits and that may shift unfunded liabilities to the PBGC.

We are concerned that employers that cover their employees under more than one defined benefit plan are able to recover funds from one plan for nonpension purposes without first ensuring benefits under the other plans. This is really a major point that this

proposal is directed to. You have one plan that is overfunded, another that it underfunded. Maybe it is the same company and maybe it is an affiliated group. They can get assets out of one plan in excess of termination liabilities and yet let the other one go down the drain, eventually terminating it to the detriment of the PBGC or the employees.

This leads into the second trend, which is the recent increase in terminations of large, seriously underfunded defined benefit plans. Because, under current law, neither the employer nor the PBGC is liable for all unfunded plan benefits after termination, such terminations have deprived many employees of their full promised benefits earned as a of termination.

Furthermore, these types of terminations have caused the financially strained PBGC to incur liability for significant unfunded benefits for which the employer is not fully liable. As you indicated, Mr. Chairman, at the end of the 1986 fiscal year, the PBGC had a deficit of almost $4 billion, so we have a serious problem there.

In many cases, these underfunded plan terminations have involved plans of employers that have at all times complied with the minimum funding requirements of ERISA. This suggests that the current rules are not adequate to protect employees against reasonably avoidable benefit losses.

In some cases, employers have undertaken such underfunded plan terminations even though they have also maintained overfunded defined benefit plans for their employees. That is the flip side of the problem I was mentioning a minute ago. An overfunded and an underfunded plan are, under current law, treated completely separately, and the employer may terminate the underfunded plan and possibly cause the employees or the PBGC to be stuck.

The primary policy goals of the administration proposal are to enhance the security of employees' retirement benefits and to protect the PBGC from reasonably avoidable unfunded liabilities, while still permitting employers to recover plan assets that are truly in excess of the plan's foreseeable funding needs.

The proposal would accomplish this in several significant ways: First, it would rationalize employer access to plan funds. It would permit employer withdrawals from ongoing plans without requiring plan termination. No complex mechanical steps are necessary, just a simple withdrawal, but there would be a limit to the extent to which employers that continue to provide defined benefit coverage to their employees would be able to recover assets through withdrawals or plan terminations.

Second, the proposal would modify the minimum funding rules. Third, it would rationalize the rules governing terminations of underfunded plans so that employers are fully liable to employees and to the PBGC for unfunded plan benefits after plan terminations. And it would limit the extent to which employees suffer benefit losses and to which the PBGC incurs unfunded plan liabilities upon termination of underfunded plans maintained by employers that also maintain overfunded plans.

Chairman PICKLE. Mr. Secretary?

Mr. MENTZ. Yes, Mr. Chairman?

Chairman PICKLE. Do you later go into some explanation of how you would limit these withdrawals?

Mr. MENTZ. Yes, I do.

Chairman PICKLE. All right.

Mr. MENTZ. We think that the public policy here, Mr. Chairman, should encourage optimal, rather than deficient or excessive, funding for defined benefit plans. An employer should have neither the incentive nor the opportunity to make pension promises that exceed its own legal liability or financial capacity.

The proposal seeks to achieve the twin goals of increased employee benefit security and PBGC protection without interfering with the ability of employers to agree to their own pension promises. The proposal does not condition an employer's recovery of plan assets upon the provision of a mandatory benefit increase and does not require that assets in excess of a plan's termination liability be shared with employees.

The proposal embodies the view that employers should remain able to make their own pension promises without Federal legislation, provided that they are fully responsible for whatever pension promises they make.

Finally, the proposal partially addresses the growing problem of funding retiree health benefits. It does this by permitting a transfer of funds that could be transferred from a pension plan into a special section 419 fund that would fund retiree health benefits. I will touch on that a bit later.

The testimony describes all the elements of the proposal in comprehensive fashion, and I would like to just touch on certain high points.

First, employer access to plan assets. As I have indicated, under current law, an employer may recover assets from a terminated plan to the extent that assets in the plan exceed a plan's termination liability to employees. A plan's termination liability means the assets in excess of earned plan benefits, vested or unvested, including contingent benefits, with no provision for future benefits.

In addition, current law permits an employer to undertake certain reversion transactions in which the employer is able to recover assets upon plan termination, even though the employer continues to maintain a defined benefit plan for these employees.

In other words, under current law an employer can go through a fairly complex transaction and withdraw assets from a defined benefit plan in excess of termination liabilities. That means you cut it all the way down to termination liabilities, pull out the rest, and let the plan basically go forward. This can be done even though the employer has another plan, or a subsidiary has another plan, that is underfunded.

We believe that it is inappropriate to leave no asset cushion in the plan from which assets are being withdrawn. Let me get to the proposal to explain how we deal with that.

The proposal would permit an employer to withdraw assets from an ongoing defined benefit plan without requiring a formal termination. Just a straightforward withdrawal would reduce many of the unnecessary transaction costs. But the proposal would prevent an employer from withdrawing all assets in excess of termination liability, requiring instead that an asset cushion in excess of the plan's termination liability remain in the ongoing plan, so that even if an employer completely terminates a plan, if he still has at

least one defined benefit plan following the termination, he will not be able to accomplish a withdrawal of all assets over termination liabilities. There will have to be an asset cushion in the remaining plan, which I will describe in a second.

In the case of an employer that has several plans or a consolidated group of companies where different subs have different plans, a withdrawal would not be permissible unless the asset cushion were maintained with respect to all plans. So, just because one plan is overfunded, an employer could not withdraw the excess over the cushion if the other plans, in the aggregate, do not have a sufficient cushion.

The cushion which I have described is defined in our proposal as a minimum benefit security level. As I indicated, it is not only with respect to the plan from which assets are being withdrawn; it also applies across the board to all defined benefit plans of the whole consolidated enterprise.

The minimum-benefit security level is equal to the greater of the full funding amount for the plans—that is, all plans—or 125 percent of termination liability. So, as you see, even if termination liability is greater than the full funding amount, this provides at least a 25-percent cushion over what current law provides. There would be a reduced cushion to the extent that benefits are annuitized but, nevertheless, a cushion.

In the case of a withdrawal, any asset reversions or assets withdrawn would be subject to regular income tax and the new 10-percent excise tax that we included in tax reform last year. There would be an exception for transfers of excess assets from overfunded to underfunded plans and also an exception for transfers from defined benefit plans to welfare benefit plans to provide health benefits for certain retirees.

This proposal does not require full vesting of employees in accrued benefits as a condition of asset withdrawal. The plan essentially goes on. The notion is that it is adequately funded, it remains adequately funded, and the excess simply comes back to the company and is subject to tax.

Again, I think it is very important to recognize that this proposal covers all plans by all members of an affiliated group, so we are putting everybody together here. You cannot take assets from overfunded plans while you or a member of your affiliated group maintain underfunded plans——

Chairman PICKLE. Regardless of the number of people then covered?

Mr. MENTZ. That is right. There is one exception, and that is that multiemployer benefit plans would be excluded, but even putting the multiemployer plan aside, even the single-employer collectively bargained plans would be included in this proposal.

Let me move to the minimum funding standards. The proposal there is to significantly revise the minimum funding rules for any plan without assets at least equal to 110 percent of the plan's termination liability to employees. The proposal would shorten the period over which employers maintaining such plans would be required to fund unfunded benefits existing on the effective date of the proposal and unfunded benefit increases arising after the effective date.

Essentially, the notion is that the more underfunded the plan is and the more mature the plan benefits are—that is, that they are benefits that are going to likely be payable in the relatively near future—the shorter the funding period for the plan's unfunded liability existing on the effective date.

The notion is that there would be an acceleration of funding requirements for benefits that are likely to be payable in the near future. The most rapidly accelerated funding would be, we would contemplate, no shorter than 3 to 5 years.

This proposal would make all members of the controlled group, including the plan's sponsor, liable under the minimum funding rules. Furthermore, the employer would be required to make the minimum contributions on a quarterly basis throughout the plan year under rules analogous to the estimated tax rules, and all liability would be required to be paid in no later than 2½ months after the end of the plan year.

The proposal would also modify the rules governing the availability of minimum funding waivers to make minimum funding waivers more nearly equivalent to commercial loans. The number of waivers permitted for any 15-year period would be reduced from five to three.

With regard to termination of underfunded plans, as I have indicated, in some cases employers may freely terminate plans that are without sufficient assets to provide employees with their total benefits, even though the employer has no continuing obligation to provide such benefits after plan termination. In such cases, the employees are simply deprived of their promised benefits.

Under current law, an employer is thus able to agree to provide employees with pension benefits for which he is not ultimately responsible. We think the employer has the right to make whatever benefit promise he chooses, but whatever promise he makes, he should be legally obligated to comply with it.

Moreover, under current law, whether a plan has sufficient assets to cover benefit commitments, and thus whether an employer may voluntarily terminate such plan without PBGC approval, is determined on a plan-by-plan basis without regard to whether the employer also maintains other defined benefit plans that have sufficient assets to cover benefit commitments. The proposal would prevent an employer from voluntarily terminating a plan unless the plan had assets at least equal to plan termination liability; in other words, at least equal to the earned benefits at the time of termination.

The proposal would make the employer personally liable to employees and the PBGC for the entire amount of the plan's termination liability. The employer would be liable to the PBGC for all unfunded benefits covered by the PBGC and to the employees for all unfunded benefits earned under the plan and not covered by the PBGC. This again is part of the theory that you can make any promise you want, but once you make it, you've got to keep it; it is a legal obligation.

Incidentally, that is the way that financial accounting reporting presently works. The benefit promises are basically reflected in certified financial statements of companies. So what we are really

doing is catching up to where the accounting standards already are.

The proposal would provide that if a plan terminates with assets less than the plan's termination liability, assets would have to be transferred from other plans of the employer and the controlled group to the terminating plan up to the level of such plan's termination liability. However, assets may not be transferred from an ongoing plan to the terminating plan to the extent that the transfer would reduce the assets in the ongoing plan to less than termination liability of the ongoing plan.

In other words, any time you have a termination, you look at how that plan is funded and how the other plans are funded, and there is sort of an adjustment, an equalization, designed to protect employees, honor the employer's benefit promise, and ensure that the tax benefits that are provided for these amounts are used legitimately.

On retiree health benefits, let me just say that, under current law, there are very limited tax-favored funding vehicles. We would propose that, where an employee has the ability to make a withdrawal from an overfunded defined benefit plan, that employer could, on a tax-free basis, transfer those funds into a welfare benefit fund that is qualified under section 419 that would provide health benefits to current retirees, not to existing employees but to current retirees. That would be a modest step forward in the funding of a very significant amount of present retiree health plan obligations that are currently outstanding.

With regard to effective dates, we would propose this legislation to be effective generally for years beginning after December 31, 1987. Certain of the rules may have to be effective earlier in order to avoid transactions set up in anticipation of the adoption of the proposal, but the proposal does not contain specific rules on that. We would think that it would be appropriate to work with the committee in designing such rules.

I would like to close by reemphasizing that the twin objectives of the administration's proposal on funding and termination of defined benefit plans are to enhance the security of employees' pension benefits and to protect the PBGC, and thus its premium payers, from liability for avoidable unfunded plan liabilities.

The proposal is not intended as a quick fix or a short-term solution to the problems of employee benefit security or the PBGC. Rather, it is designed as a comprehensive and rational approach to improving benefit security over an extended period.

The administration looks forward to working with the Subcommittee on Oversight as well as the full Ways and Means Committee in considering the proposal. We hope that, in the very near future, we can begin working together with all the appropriate committees to draft statutory language reflecting this proposal for formal legislative consideration.

Thank you, Mr. Chairman.

[Statement of Mr. Mentz follows:]

For Release Upon Delivery
Expected at 9:00 a.m., EDT
March 6, 1987

STATEMENT OF
J. ROGER MENTZ
ASSISTANT SECRETARY (TAX POLICY)
DEPARTMENT OF THE TREASURY
BEFORE THE SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

Mr. Chairman and Members of the Subcommittee:

The Administration recently offered a Proposal (the "Proposal") that would significantly alter the rules relating to the funding and termination of defined benefit pension plans. Private pension plans are an important source of retirement income for many American workers, and the Administration believes that recent trends demonstrate the need to provide additional protection for employees' benefits under such plans.

I am privileged to have with me this morning the Honorable Dennis M. Kass, Assistant Secretary (Pension and Welfare Benefits Administration), Department of Labor; Dr. Kathleen P. Utgoff, Executive Director of the Pension Benefit Guaranty Corporation (PBGC); and William B. Posner, Assistant Director of the Employee Plans Technical and Actuarial Division of the Internal Revenue Service. All of the agencies represented here this morning have worked in close cooperation to develop this administration Proposal. We welcome this opportunity to discuss the Administration's views on the Proposal.

OVERVIEW

Employer-maintained pension plans are subject to the provisions of the Employee Retirement Income Security Act of 1974 ("ERISA"). One of the main purposes of ERISA is to assure the security of benefit promises made to employees under defined benefit pension plans. To this end, ERISA imposes minimum funding standards upon defined benefit plans, regulates the investment of plan assets, and strictly limits employer access to such assets. In addition, ERISA provided for the creation of the PBGC to guarantee certain benefits under defined benefit plans that terminate with insufficient assets.

The rules of ERISA have largely accomplished their intended purposes. However, two disquieting trends relating to defined benefit plans have led the Administration to conclude that certain weaknesses in current law permit employers to act in ways that could diminish the security of employees' benefits and lead to an increased financial burden on the PBGC.

Asset Reversions

First, in recent years a significant number of employers have terminated their overfunded defined benefit plans to recover assets in excess of the plan's termination liability. PBGC data indicate that, since may 1980, the asset reversions involved in

both completed and pending plan terminations total about $16 billion. This amount represents about 45 percent of the total assets in the affected plans and about 2 percent of the total assets in all defined benefit plans.

Current law permits these asset reversions even though employers continue to cover the affected employees in ongoing defined benefit plans. (That such transactions are legal was formally recognized by the Asset Reversion Implementation Guidelines, Issued in May 1984 by the Departments of Treasury and Labor, the IRS, and the PBGC.) By enabling employers to access all assets in excess of the employees' benefits earned to date (i.e., the plan's "termination liability"), such reversion transactions may erode the protections afforded by the current funding rules, thus potentially diminishing the security of employees' benefits. The funding rules require that an employer's minimum annual contribution be based on both the employees' benefits earned to date and on employees' projected benefits. This not only protects benefits earned to date from adverse investment experience, but also provides an added margin of security for future benefit accruals and increases the likelihood that employees will receive future benefit increases.

In addition, current law permits an employer to undertake a reversion transaction with respect to a defined benefit plan even though the employer also maintains another, seriously underfunded defined benefit plan that, in a subsequent termination, may be unable to provide employees with their full, promised benefits and may shift unfunded liabilities to the PBGC. Because funds in qualified defined benefit plans receive significant tax benefits, we are concerned that employers that cover their employees under more than one defined benefit plan are able to recover funds from one plan for non-pension purposes without first ensuring that benefits under the other plans are adequately secure.

Terminations of Underfunded Plans

The second trend is the recent increase in the terminations of large, seriously underfunded defined benefit plans. Because, under current law, neither the employer nor the PBGC is liable for all unfunded plan benefits after termination, such terminations have deprived many employees of their full, promised benefits earned as of termination. In addition, these terminations have caused the financially strained PBGC (and, thus, other premium payors) to incur liability for significant unfunded benefits for which the employer is not fully responsible. By the end of its 1986 fiscal year, the PBGC faced its greatest deficit--almost $4 billion--and the largest claims in its 12-year history.

In many cases, these underfunded plan terminations have involved plans of employers that had at all times complied with the minimum funding requirements of ERISA. This indicates that the current rules do not adequately protect employees against reasonably avoidable benefit losses, or the PBGC against avoidable unfunded benefit liabilities. In addition, in some cases employers have undertaken such underfunded plan terminations even though they also maintain overfunded defined benefit plans for their employees. It is troubling that employers can impose benefit losses on some employees and shift unfunded plan liabilities to the PBGC when, at the same time, there are tax-favored assets in other defined benefit plans that could be used to provide such benefits.

Policy Objectives

The primary goals of the Administration's Proposal are to enhance the security of employees' retirement benefits and to protect the PBGC (and its premium payors) from reasonably avoidable unfunded liabilities, while still permitting employers to recover plan assets that are truly in excess of the plan's foreseeable funding needs. The Proposal would accomplish these objectives in several significant ways.

1. The Proposal would rationalize employer access to plan funds by (i) permitting employer withdrawals from ongoing plans without requiring plan terminations, but (ii) limiting the extent to which employers that continue to provide defined benefit plan coverage to their employees are able to recover assets through withdrawals or plan terminations.

2. The Proposal would modify the minimum funding rules to (i) limit the ability of employers to delay, or avoid, making minimum funding contributions for a year, and (ii) improve the funded status of underfunded defined benefit plans by requiring that certain unfunded benefits be funded over shorter periods and that the required minimum contribution be at least sufficient to cover a plan's annual cash flow needs.

3. The Proposal would rationalize the rules governing terminations of underfunded defined benefit plans to (i) assure that employers are fully liable to employees and to the PBGC for unfunded plan benefits after plan terminations, and (ii) limit the extent to which employees suffer benefit losses and the PBGC incurs unfunded plan liabilities upon termination of underfunded plans maintained by employers that also maintain overfunded plans.

The Administration believes that public policy should encourage optimal, rather than deficient or excessive, funding of defined benefit plan benefits. An employer should have neither the incentive nor the opportunity to make pension promises that exceed its own legal liability or financial capacity. The purpose of sound funding is to protect employees' benefits by insulating them from the business risk of the employer, as well as to protect the PBGC from systematic loss. In addition, for reasons of both tax policy and economic efficiency, employers should not be required to fund their benefit promises beyond a level that reasonably assures that such benefits will be paid when due.

The Proposal seeks to achieve the twin goals of increased employee benefit security and PBGC protection without interfering with the ability of employers to agree to their own pension promises. For example, the Proposal does not condition an employer's recovery of plan assets upon the provision of a mandatory benefit increase and does not require that assets in excess of a plan's termination liability be shared with employees. Any such requirements would likely be of illusory benefit to employees and could well discourage proper plan funding. The Proposal thus embodies the view that employers should remain able to make their own pension promises, provided that they are fully responsible for whatever pension promises they make.

Retiree Health Benefits

Finally, the Proposal would partially address the growing problem of funding retiree health benefits. Increasingly, employers are interested in providing their retirees with health coverage. However, there is concern that many employers, particularly employers with rapidly maturing workforces, are discouraged from offering retiree health benefits, while others that now provide such benefits are being forced to discontinue or cut back such benefits because no appropriate funding mechanism is provided. The Proposal seeks to mitigate this problem by permitting employers to transfer, without current tax consequences, a portion of the defined benefit plan assets that are available for recovery by the employer to a fund to provide current retirees with health coverage.

The Administration recognizes that the Proposal does not fully address the problem of funding retiree health benefits. However, we have concluded that it is not appropriate to permit broader, tax-favored prefunding of retiree health benefits at this time. First, the revenue consequences of broader prefunding would be significant. Current budgetary constraints simply do not permit broader tax benefits for prefunding retiree health benefits. (Note that the revenue loss attributable to the retiree health changes contained in the Proposal is minimal.) Second, broader, tax-favored prefunding should be permitted only if it is structured in such a way that the public costs are matched by the public benefits, such as through the application of minimum standards similar to those that apply to qualified pension plans.

MAJOR ELEMENTS OF THE PROPOSAL

The Proposal embodies four major elements: rules rationalizing employer access to defined benefit plan assets; improvements to the plan funding rules; rules rationalizing the treatment of underfunded plan terminations; and special treatment for asset transfers to welfare benefit funds to provide health benefits to current retirees. The following describes these elements in a more comprehensive fashion.

1. Employer Access to Plan Assets

Current Law

An employer that maintains a defined benefit plan is required to fund the plan in accordance with the minimum funding standards of ERISA. These standards were developed to ensure (i) that employers make contributions to fund not only employees' accrued benefits, but also a portion of employees' projected benefits, and (ii) that employees' benefits would be protected against adverse investment experience. Frequently, defined benefit plans that are funded in accordance with the minimum funding standards accumulate assets in excess of their termination liability to employees.

While an employer is generally prohibited from recovering assets from an ongoing defined benefit plan, current law provides that an employer may recover assets from a terminated plan to the extent that such assets exceed the plan's termination liability to employees. (A plan's termination liability to employees generally includes all earned plan benefits that are vested or unvested, including contingent benefits.) In addition, current law permits an employer to undertake certain reversion

transactions in which the employer is able to recover assets upon a plan termination even though the employer continues to maintain a defined benefit plan for the affected employees. In effect, these reversion transactions permit an employer to "withdraw" assets from an ongoing plan. Typical examples of such transactions are termination/reestablishment transactions (e.g., termination of an overfunded plan followed by the establishment of a new defined benefit plan for the same employees) and spinoff/termination transactions (e.g., splitting of a single overfunded plan into (i) a plan with retirees and excess assets, which is terminated to enable the employer to recover the excess assets, and (ii) an ongoing plan with active employees and assets equal to the plan's termination liability with respect to such employees).

By undertaking such a reversion transaction, an employer is effectively able to recover all plan assets from an ongoing defined benefit plan in excess of the plan's termination liability. Although all benefits earned to date would have to be annuitized under a reversion transaction, the ongoing plan would have no asset cushion above the level of the plan's termination liability. The absence of this cushion reduces employees' security with respect to future benefits and may also discourage employers from providing for future benefit increases.

Furthermore, the current rules regulating employer access to plan assets operate on a plan-by-plan basis; as a result, it is easier for an employer with multiple plans to recover plan assets than for an employer with a single defined benefit plan. For example, under current law, if an employer maintains only one defined benefit plan, the employer may not recover plan assets unless the plan has sufficient assets to satisfy the benefits of all covered employees. However, if an employer maintains multiple plans, the employer is permitted to recover assets in an overfunded plan regardless of whether the other plans have sufficient assets to satisfy the benefits of the employees in such plans.

Many employers currently maintain relatively well-funded plans for their salaried employees and underfunded plans for their hourly employees. Some of these employers have received asset reversions from their overfunded plans and then terminated their underfunded plans, thereby depriving employees of their full benefits and, in some cases, shifting unfunded liabilities to the PBGC. Because the plan-by-plan approach of current law encourages employers to maintain multiple plans funded at different levels in order to maximize their access to tax-favored plan assets at the expense of benefit security, the Proposal consistently replaces the plan-by-plan approach with an aggregate plan approach.

In general, asset reversions are subject to the regular income tax and a ten percent excise tax. There is a limited exception, however, for certain reversions that are transferred to employee stock ownership plans prior to January 1, 1989.

Proposal

The Proposal would permit an employer to withdraw assets from an ongoing defined benefit plan without requiring a formal plan termination. This would reduce many of the unnecessary transaction costs associated with a formal plan termination. At the same time, however, the Proposal would prevent an employer from withdrawing all assets in excess of a plan's termination

liability, requiring instead that an asset cushion in excess of the plan's termination liability remain in the ongoing plan. In addition, the extent to which an employer could withdraw assets from an ongoing plan would depend, in part, on whether other plans maintained by the employer (and the controlled group) are adequately funded, thereby eliminating the current law disparity between employers with a single defined benefit plan and employers with multiple plans. Therefore, the Proposal in effect treats all defined benefit plans of an employer (and the controlled group) as a single plan for purposes of determining the amount of plan assets available to an employer. (However, multiemployer plans are not taken into account.)

Under the Proposal, an employer would be permitted to withdraw assets from an ongoing defined benefit plan to the extent that, following the withdrawal, each of the following conditions is satisfied: (i) the value of the assets in the plan of withdrawal exceeds the "minimum benefit security level" for such plan, and (ii) the value of the assets in all other plans of the employer and the controlled group of which the employer is a part exceeds the "minimum benefit security level" for all such other plans (calculated as though such other plans were a single plan). The "minimum benefit security level" for the plan of withdrawal and for all other plans of the employer and controlled group would be equal to the greater of (i) the full funding amount for the plan(s), or (ii) 125 percent of the termination liability of the plan(s). (Our data indicate that approximately 24 percent of the defined benefit plans covering at least 100 employees have assets above 125 percent of termination liability.)

A reduced cushion would be allowed to the extent that benefits are annuitized under the plan. For annuitized benefits, the minimum benefit security level would be equal to the greater of (i) the termination liability of the plan(s) plus 40 percent of the excess of the full funding amount of the plan(s) over the termination liability of the plan(s), or (ii) 110 percent of the termination liability of the plan(s).

The full funding amount for a plan is the point at which the minimum funding rules treat a defined benefit plan as sufficiently funded so as to require no additional contributions for that year. In plans that base benefits on employees' final salaries, the full funding amount is likely to be greater than 125 percent of the plan's termination liability. However, in plans that simply provide a flat dollar benefit for specified periods of service and plans that cover a very high proportion of retirees (relative to the number of active employees covered), the full funding amount will be much closer to the termination liability. In these cases, 125 percent of the plan's termination liability generally will be the applicable minimum benefit security level.

Under the Proposal, all asset reversions and asset withdrawals would be subject to the regular income tax and the ten percent excise tax on asset recoveries from qualified plans. there would be an exception, discussed later, for certain transfers from defined benefit plans to welfare benefit funds to provide health benefits for current retirees.

As part of the effort to rationalize the applicable rules governing employer access to plan funds, the Proposal does not require that employees vest fully in their accrued benefits as a condition of an asset withdrawal. Full vesting is required under

current law in the case of the termination of an overfunded plan; the Proposal would not alter this rule. However, given the other elements of the Proposal (in particular, the proposed limits on employer access to plan assets), full vesting is not necessary where the defined benefit plan is ongoing and employees have the opportunity, after the withdrawal, to complete additional years of service under the vesting rules.

The cushion requirement on asset withdrawals would be defeated if employers could recover more assets through plan terminations than through asset withdrawals. Consistent with treating all defined benefit plans maintained by an employer (and the controlled group) as a single plan for purposes of determining the extent to which assets may be withdrawn from a plan, the Proposal treats a termination reversion received by an employer that continues to maintain other defined benefit plans as equivalent to a withdrawal from an ongoing defined benefit plan.

Accordingly, an employer (and the controlled group) would not be permitted to recover more assets through a plan termination reversion than through an asset withdrawal if such employer (and the controlled group) continues to maintain one or more defined benefit plans. In such case, assets in excess of the terminating plan's termination liability but not in excess of the minimum benefit security level that would apply for withdrawal purposes would have to be transferred to the ongoing defined benefit plans maintained by the employer (or the controlled group) before the plan is terminated. An employer that, following the termination of a plan, continues to maintain one or more defined benefit plans would be prohibited from covering the affected employees under another defined benefit plan (including a multiemployer plan) for five years.

If, following a plan termination, the employer (and the controlled group) does not maintain any other defined benefit plan, it would be inappropriate to limit the assets available to the employer to the assets that would have been available to the employer through an asset withdrawal. (Indeed, after a bona fide plan termination in which all plan benefits are properly annuitized, there would be no ongoing investment risk or future benefits to justify the maintenance of an asset cushion.) Thus, under the Proposal, when an employer terminates a defined benefit plan and, thereafter, maintains no additional defined benefit plan, the employer would be able to recover all assets in excess of the plan's termination liability (as under current law). However, such an employer (and the controlled group) would be precluded from covering any employees under another defined benefit plan (including a multiemployer plan) for five years. (Appropriate exceptions would be developed for employers acquiring divisions or subsidiaries with pre-existing defined benefit plans.)

Some have questioned whether the structure of the Proposal would encourage employers to terminate all of their defined benefit plans in order to recover all assets in excess of the plans' termination liabilities. Very few employers (in particular, unionized employers) are likely to depart entirely from the defined benefit plan system, particularly in view of the five-year prohibition from maintaining a defined benefit plan. In addition, it is important to note that, under the Proposal, full vesting and benefit annuitization would continue to be required on plan termination, but would not be required in the case of an asset withdrawal. In addition, the withdrawal

proposal provides for a reduced cushion in the case of any benefits that are annuitized. These factors should further reduce the incentive for employers to terminate all of their defined benefit plans in order to access the asset cushion.

The Proposal recognizes that an employer can accomplish an economic result equivalent to a plan termination and asset reversion through a transfer of plan sponsorship to another employer (beyond the transferring employer's controlled group). Such an employer is able to realize the benefit of excess plan assets through adjustments in the terms of the sale of the subsidiary or division accompanying the transfer of sponsorship. Thus, the Proposal would treat a transfer of plan sponsorship beyond the employer's controlled group as a plan termination for purposes of determining the extent to which assets in excess of such plan's termination liability may be transferred with the plan.

For example, if plan sponsorship is transferred beyond the controlled group in connection with the sale of a subsidiary or division, assets in excess of the plan's termination liability would be permitted to remain in the plan only to the extent that the employer could have recovered such assets through a termination of the plan and an asset reversion. Prior to the transfer of plan sponsorship, any assets not available to the employer on plan termination would have to be transferred to other defined benefit plans of the employer (or the controlled group). To the extent that assets available for employer recovery on a plan termination remain in the plan that is being transferred to a new sponsor, such assets are treated as having reverted to the transferring sponsor. Of course, if an employer (and the controlled group) does not maintain any other defined benefit plan after a transfer of plan sponsorship, the amount of excess assets transferred would not be limited.

We recognize that such rules could interfere with corporate transactions (e.g., mergers and acquisitions) involving a change in plan sponsorship. Accordingly, special efforts should be taken to minimize the disruptive effect of the asset recovery rules on such transactions, without undercutting the policies embodied by the Proposal.

Some have argued that employers should be required to share some portion of any plan asset recovery with employees through mandated benefit increases. The Administration considered such a proposal, but rejected any rule requiring employers to share excess assets with employees, because such a rule could undermine funding incentives to the long term detriment of employees and the PBGC. In addition, we rejected a proposal providing for a mandated benefit increase to employees upon plan termination without regard to the funded status of the terminating plan. Employers anticipating a plan termination would be able to defeat the purpose of such a rule by reducing future benefit formulas so that their total plan costs remained constant; such actions would cause a mandated increase to be more illusory than real. In addition, it is more important to improve the security of employers' agreed-to pension promises rather than acting to increase such promises by law.

2. Minimum Funding Standards

Current Law

The minimum funding standards imposed by ERISA require that

an employer contribute an annual amount sufficient to fund employees' benefits determined in accordance with one of several prescribed funding methods, using actuarial assumptions that are reasonable in the aggregate. The annual amount required to be contributed under the minimum funding rules consists of two components: normal cost (i.e., a charge relating to the current year of service); and a portion of the plan's unfunded accrued liabilities (i.e., all charges other than normal costs). A plan's unfunded accrued liabilities can grow to be quite significant depending upon the funding method, the frequency of benefit increases, whether or not past service credit is granted to employees, and the investment experience of the plan.

In general, the minimum funding standards permit an employer to fund a plan's unfunded accrued liabilities over an extended amortization period (usually, 30 years). Such spreading is allowed regardless of the plan's level of underfunding or the extent to which a plan's unfunded liabilities are attributable to past service benefits.

The total annual contribution must be paid to the plan no later than 2-1/2 months after the close of the year to which the contribution relates. Treasury regulations generally extend this due date by six months. If an employer is able to demonstrate that the required minimum funding contribution for a year would impose a substantial business hardship, the employer may request a minimum funding waiver from the Internal Revenue Service.

The current minimum funding rules do not adequately assure that plans will have sufficient assets to pay employees' benefits when they become due. In particular, the fixed 30-year amortization period used for funding benefit increases may be too long to assure proper benefit security in many situations. As a result, even where employers fully comply with the minimum funding rules, unfunded plan liabilities can build to levels that threaten employees' benefit security and produce potentially large claims against the PBCC insurance program.

Proposal

The Proposal would significantly revise the minimum funding rules for any plan without assets at least equal to 110 percent of the plan's termination liability to employees. The Proposal would shorten the period over which employers maintaining such plans would be required to fund (i) unfunded benefits existing on the effective date of the Proposal, and (ii) unfunded benefit increases arising after the effective date. The exact duration of the funding period for any plan would depend upon two factors: the extent to which the plan is underfunded, and the maturity of the plan's benefits (i.e., the extent to which a plan's total unfunded liabilities are attributable to past service benefits). An example of a plan with mature plan benefits is a recently improved defined benefit plan that covers relatively older employees who have significant past service credits. Essentially, the more underfunded the plan and the more mature the plan's benefits, the shorter the funding period for the plan's unfunded liability existing on the effective date and unfunded benefit increases after the effective date.

At present, we contemplate that in no case would an employer be required to fund these unfunded liabilities over a period shorter than three-to-five years. In addition, we expect that many of the better-funded plans with assets less than 110 percent of termination liabilities will retain the funding

periods applicable under current law, i.e., will be unaffected by this portion of the Proposal.

In order to prevent the deterioration of a plan's funded status due generally to experience losses and to certain benefit increases not triggering a shorter funding period under the preceding rule, the Proposal would also require employers to fund any deterioration in a plan's funded status below 110 percent of the plan's termination liability over a minimum period, such as three years.

The Proposal also would apply a "cash flow" minimum funding rule to any plan with assets below 110 percent of its termination liability. Under this rule, the minimum funding contribution for a year would never be less than the total distributions and expenses of the plan for the year, or the amount needed to bring the plan to 110 percent of termination liability, whichever is less. (Special rules would be developed for retiree-only and frozen plans.)

We are continuing to develop the technical aspects of these particular funding proposals, so it is not presently possible to provide you with exact specifications. Of course, we will supplement this testimony after completing the development of these technical rules.

Consistent with requiring employers to make larger minimum contributions to underfunded plans, the Proposal would modify the deduction rules to allow an employer to make a deductible contribution to a defined benefit plan in excess of the otherwise applicable deduction limits (taking into account the changes to the minimum funding rules contained in this Proposal). However, this rule would not permit a deduction for an otherwise nondeductible contribution to the extent that such contribution causes either the plan's assets to exceed the plan's termination liability or the assets in all plans of the controlled group to exceed the total termination liability of all such plans. This modification would also have the effect of waiving the ten percent excise tax on such contributions.

In addition to applying special funding rules to underfunded plans, the Proposal would modify several of the funding rules applicable to all defined benefit plans. The Proposal would make all members of the controlled group, including the plan sponsor, liable under the minimum funding rules. In addition, the employer (and the controlled group) would be required to make the required minimum contributions on a quarterly basis through the plan year under rules analogous to the estimated income tax rules. Furthermore, the total required contribution for a plan year would be due no later than 2-1/2 months after the end of the plan year. It is intended that this acceleration of contribution due dates will serve as an effective early warning system of possible employer difficulty for employees, the IRS and the PBGC. Finally, the Administration believes that it would be appropriate to consider special rules to address the funding problems created by certain types of contingent benefits, such as shutdown benefits.

The Proposal would also modify the rules governing the availability of minimum funding waivers. Under the Proposal, a waiver application would have to be filed within 2-1/2 months after the end of the plan year. In addition, the standards for granting a waiver would be clarified by providing that the employer seeking a waiver would have to establish that the

hardship was temporary and that the hardship affected the entire controlled group. To make minimum funding waivers more equivalent to commercial loans, the interest rate required on waived contributions would be increased from the interest rate applicable to the late payment of taxes under section 6621(b) of the Internal Revenue Code of 1986 (the "Code") to the greater of the plan's funding rate or the market rate for loans to distressed companies. The number of waivers permitted for any 15-year period would be reduced from five to three, and the period over which waived contributions would have to be funded would be reduced from 15 years to a period of time that would be based on the extent of plan underfunding.

There has been much discussion about the continuation of the funding waiver program. However, there may be valid pension policy reasons for the continuation of funding waivers in certain circumstances; the elimination of waivers could prompt some employers to discontinue their pension plans while they were recovering from temporary financial reverses. Nevertheless, waivers have too often been used to generate funds for distressed companies at terms much better than the companies could obtain commercially. Although the Proposal will serve to limit much of the abuse of the waiver program, additional restrictions on funding waivers should be considered to ensure that they are granted only when absolutely necessary.

3. Terminations of Underfunded Plans

Current Law

An employer may voluntarily terminate an underfunded defined benefit plan if the plan has assets sufficient to provide "benefit commitments." Benefit commitments generally refer to all vested, earned pension benefits for which all eligibility conditions have been satisfied as of the date of termination. In nearly all cases, benefit commitments are less than the benefits that constitute a plan's termination liability. Accordingly, in some cases employers may freely terminate plans that are without sufficient assets to provide employees with their total benefits even though the employer has no continuing obligation to provide such benefits after the plan termination. In such cases, the employees are simply deprived of their promised benefits.

An employer may voluntarily terminate a defined benefit plan that does not have sufficient assets to cover benefit commitments only in a "distress termination" (i.e., the employer must be in financial distress). The PBGC may, through an involuntary termination procedure, terminate such a plan when it deems appropriate. Following the distress or involuntary termination of a plan without sufficient assets to satisfy benefit commitments, an employer's liability to employees is less than the full amount of the unfunded benefit commitments (which amount is less than the full amount of the plan's termination liability to employees), and an employer's liability to the PBGC is less than the full amount of the unfunded PBGC guaranteed benefits.

Under current law, an employer is thus able to agree to provide employees with pension benefits for which it is not ultimately responsible. In addition, employers have a reduced incentive to fund their plans above the level of their liability for unfunded benefits after plan termination. Because this level generally is less than the plan's termination liability to employees, it is more likely that employees will not receive

their full promised pension benefits after a plan termination and that the PBGC will be required to provide unfunded guaranteed benefits. As a result, the rules prescribing an employer's ultimate liability for funding benefits may cause employees to be misled with respect to their ultimate pension benefits. Moreover, experience demonstrates that even the checks and balances basic to arm's length collective bargaining do not ensure that an employer will properly fund its pension promises.

Under current law, whether a plan has sufficient assets to cover benefit commitments, and thus whether an employer may voluntarily terminate such plan without PBGC approval, is determined on a plan-by-plan basis, without regard to whether the employer also maintains other defined benefit plans that have sufficient assets to cover benefit commitments. In addition, the extent to which employees suffer benefit losses on termination of an underfunded plan depends entirely on the funded status of the terminating plan; the funded status of the other defined benefit plans maintained by the employer is immaterial. Accordingly, employees are more likely to suffer benefit losses on plan termination and the PBGC is more likely to take on unfunded liabilities if an employer maintains more than one defined benefit plan than would be the case if the employer maintained a single plan for all employees.

Proposal

To encourage adequate funding of promised pension benefits, the Proposal would prevent an employer from voluntarily terminating a plan (other than through a distress termination) unless the plan had assets at least equal to the plan's termination liability. In addition, the Proposal would make an employer liable to employees and the PBGC for the entire amount of the plan's termination liability. Thus, after the termination of a plan with assets insufficient to satisfy benefit commitments, the employer would be liable to the PBGC for all unfunded benefits covered by the PBGC and to the employees for all unfunded pension benefits earned under the plan and not covered by the PBGC. Assets collected in satisfaction of the expanded employer's liability would be allocated among participants' benefits under the current law asset allocation rules, except that the value of the PBGC's claim for 30 percent of the employer's net worth would be allocated exclusively to unfunded guaranteed benefits. The Proposal would not affect the priority of the claims of employees and the PBGC in bankruptcy.

Also, consistent with the rules governing asset withdrawals and asset reversions, which treat multiple defined benefit plans maintained by a single employer (and the controlled group) as a single plan, the Proposal would provide that if a plan terminates with assets less than the plan's termination liability, assets would have to be transferred from other plans of the employer (and the controlled group) to the terminating plan up to the level of such plan's termination liability. However, assets may not be transferred from an ongoing plan to the terminating plan to the extent that the transfer would reduce the assets in the ongoing plan to less than the termination liability of the ongoing plan. (A similar rule would apply if an underfunded plan is transferred to a new plan sponsor rather than terminated.)

Some have expressed concern about transferring assets from an ongoing defined benefit plan for the benefit of participants in a terminating plan. However, without such a rule, employers would be able to terminate their underfunded plans so as to

create (or increase) the asset cushion in the remaining plan(s) and, by so doing, gain access to plan assets through a subsequent withdrawal or termination. Moreover, such transfers promote equity, by protecting the benefits of employees under a plan to which contributions will no longer be made, at the cost of removing excess assets from an ongoing plan, to which contributions will continue to be made.

Finally, the Proposal would clarify that if an employer terminated a plan that did not have adequate assets to provide PBGC guaranteed benefits, such employer (and the controlled group) would be prohibited from establishing a retirement program with substantially similar benefits within a five-year period. Such prohibition could be waived at the discretion of the PBGC. (Appropriate exceptions would be developed for employers acquiring subsidiaries or divisions with pre-existing defined benefit plans.)

4. Retiree Health Benefits

Current Law

Under current law, employers may provide limited tax-favored funding for retiree health benefits using one of two vehicles: (i) a trust established under section 401(h) of the code, or (ii) a welfare benefit fund described in section 419 of the code. A trust established under section 401(h) must be established incidental to a pension plan and the retiree health benefits provided thereunder must be subordinate to the pension benefits provided by the plan. Contributions to a section 401(h) trust established in conjunction with a pension plan are limited to 25 percent of pension contributions made after the date of the establishment of the section 401(h) trust and are subject to the overall limits of benefits and contributions under section 415. Income on reserves set aside pursuant to section 401(h) is exempt from taxation.

Funds for retiree health benefits may also be set aside in a welfare benefit fund described in section 419. An employer may make annual deductible contributions to such a fund for retiree health benefits. The amount which may be contributed to such a fund is governed by section 419, which requires that the amount contributed must be based upon actuarially determined assumptions. Income on assets set aside in a welfare benefit trust for retiree health benefits is treated as unrelated business income and, as such, is subject to tax.

Proposal

Under the Proposal, an employer would be permitted to transfer assets available for an asset withdrawal from a defined benefit plan to a welfare benefit fund to provide health benefits to current retirees (i.e., retirees at the time of the transfer). The asset transfer would be tax-free and the transferred amounts would have to be used to provide health benefits to current retirees. Such transfer would not otherwise alter the employer's legal liability to retirees for health benefits.

The Proposal would also repeal section 401(h), but would permit amounts held in a section 401(h) account to be transferred tax-free to a welfare benefit fund subject to the rules of section 419. Amounts so transferred could continue to grow on a tax-exempt basis.

The Proposal would repeal section 401(h) because the Administration believes that health benefits should not be provided through the mechanism of a retirement plan. Because of the basic differences in the nature of the benefits, rules designed for pension benefits do not rationally apply to retiree health benefits. Moreover, since appropriate rules providing for retiree health benefits were developed for welfare benefit funds, we feel that the tax-favored funding of such benefits should be permitted only through such funds.

Although the Proposal does not address the problems of retiree health coverage in a comprehensive fashion, certain aspects of the Proposal should be stressed. First, even though the Proposal would provide favorable tax treatment for defined benefit plan asset transfers to fund retiree health benefits, such transfers would be permitted only after an employer's pension promises have been fully funded. Thus, assets may be transferred for retiree health benefits only to the extent that such assets could be withdrawn from the plan for other, non-benefit purposes. Second, making the tax-favored funding of retiree health benefits contingent on the continuation and proper funding of a defined benefit plan may encourage some employers to fund their defined benefit plans more fully.

The Administration considered permitting tax-favored prefunding of retiree health benefits over employees' working lifetimes (analogous to the funding of defined benefit plans). However, such a broad approach would occasion unacceptable revenue costs. In addition, such tax-favored prefunding is not appropriate unless the public costs are at least matched by the public benefits, such as through the application of minimum standards similar to those that apply to qualified plans (e.g., participation, vesting, benefit accrual, and funding standards). While such a broad approach may be considered in the future, it would be imprudent to delay action on the plan funding and termination proposals pending full consideration of such an approach.

5. Effective Dates

The Proposal would generally be effective for years beginning after December 31, 1987. However, to prevent transactions that would be entered into in anticipation of the adoption of the Proposal, certain of the rules may have to be effective earlier.

Finally, we expect that transition rules will be developed as appropriate. However, on this point, we are quite concerned that transition rules not render the objectives of the Proposal unattainable. Of course, some will argue that certain industries and certain companies should be exempt from the Proposal. It is appropriate that certain rules phasing-in aspects of the Proposal be considered. However, in our view, industry-wide or company exemptions from application of the rules are not appropriate.

CONCLUSION

I would like to close by reemphasizing that the twin objectives of the Administration's Proposal on the Funding and Termination of Defined Benefit Plans are to enhance the security of employees' pension benefits and to protect the PBGC (and thus its premium payors) from liability for avoidable unfunded plan liabilities. The Proposal is not intended as a quick fix or short-term solution to the problems of employee benefit security

or the PBGC, but rather is designed as a comprehensive and rational approach to improving benefit security over an extended period.

The Administration looks forward to working with the Subcommittee on Oversight, as well as the full Ways and Means Committee, in considering this Proposal. We hope that in the very near future we can begin working together with all of the appropriate committees to draft statutory language reflecting this Proposal for formal legislative consideration.

Thank you very much.

Chairman PICKLE. Well, we thank you, Mr. Secretary. You have given us a good explanation of the proposal and the rationale behind some of the things. We will have additional questions for you, but we appreciate your presentation.

Now I am going to ask that the next witness will be Dennis Kass, the Assistant Secretary for Pension and Welfare Benefits Administration, representing the Department of Labor.

Mr. Kass, would you proceed to make your statement?

Mr. KASS. Yes, I will.

Chairman PICKLE. Incidentally, I will see that the entire statements of all the witnesses will be made a part of the record.

STATEMENT OF HON. DENNIS M. KASS, ASSISTANT SECRETARY FOR PENSION AND WELFARE BENEFITS, U.S. DEPARTMENT OF LABOR

Mr. KASS. Thank you, Mr. Chairman, and thank you, Mr. Thomas.

I will be redundant in places of Mr. Mentz's testimony, but I think those points are probably worth making twice, and I hope this summary is helpful.

The primary objectives of the proposal, as Mr. Mentz pointed out, are to make more secure the retirement benefits of the nearly 35 million American workers who are covered by single-employer defined benefit pension plans; and, second and of equal importance, to reduce the financial burdens imposed on the Pension Benefit Guaranty Corporation.

The Department of Labor has primary responsibility for protecting the retirement and other employee benefit security of the millions of Americans covered under the private pension and welfare benefit plans offered by private employers in this country. As such, my remarks will focus on the proposal's effect on the benefit security of plan participants and the integrity of the overall private pension system.

I would like to point out that the submission of this proposal fulfills the responsibility of the Secretary of Labor as set forth in the Single-Employer Pension Plan Amendments Act passed last year to report to the Congress our legislative recommendations concerning reversions of residual assets from the termination of overfunded plans.

Chairman PICKLE. Mr. Kass, would you suspend? We have a run on the table over here for statements. Until the members can get copies of it, let's just suspend a minute.

Mr. KASS. All right, sir.

[Pause.]

Chairman PICKLE. Now, Mr. Kass, will you proceed?

Mr. KASS. Yes, sir.

Secretary Brock has had a long-standing personal commitment to offer legislation in this area, has exerted leadership in guiding the administration toward the offering of a proposal, and, as I just pointed out, this proposal fulfills his responsibility under SEPPAA to report legislative recommendations to the Congress.

With respect to underfunded plans, there are two obvious and very troubling results. The first is that workers may not receive

their full accrued benefits, and the second, and perhaps more obvious one, is that there are massive and growing liabilities imposed on the Pension Benefit Guaranty Corporation.

The administration believes that many of the losses being imposed on plan participants and the PBGC are due to deficiencies in the current termination and funding provisions of ERISA, and are avoidable. While in general pension plans are well funded, as Roger pointed out, currently there is approximately $45 billion in the aggregate of underfunding in the pension system, and in fact the funding status of some plans has deteriorated in spite of compliance with ERISA's current minimum funding standards.

As a result, we have concluded that fundamental changes in the termination and funding provisions of ERISA are essential in order to avoid, or at least to minimize, the inappropriate imposition of future losses on plan participants and the PBGC.

With respect to overfunded plans, currently there is approximately $200 billion of overfunding on a termination basis. While overfunded plans do not represent an immediate threat to participants' benefit security—obviously quite the contrary—there are inadequacies in current law that need to be addressed concerning employer access to excess assets.

Specifically, under current law, the only means of obtaining access to any surplus that may accumulate through favorable investment experience or additional contributions is through plan termination. Terminations are costly, they are disruptive, and they can have an adverse effect on the future benefit security of plan participants.

Terminations and asset reversions may decrease the extent or the likelihood of future benefit increases or ad hoc cost-of-living allowances for retirees, and the reason, as Mr. Mentz pointed out, is due to the the way surplus is defined under current law. Under current law, an employer may engage in a transaction pursuant to the Implementation Guidelines which were issued jointly by the PBGC, Treasury and the Labor Department either a termination reestablishment or a spinoff termination, and withdraw assets that exceed termination liabilities from what is essentially an ongoing plan.

In fact, at least a portion of those assets that exceed termination liabilities relate to the projected liabilities and relate in fact to the funding target that the plan is aiming for in its ongoing contributions, and therefore, at least a portion of the so-called overfunding does not represent true surplus.

As a result, the solvency of a retirement plan may be subject to greater exposure to future market declines. In addition, the current law relating to asset reversions, ignores the fact that an ongoing plan's funding target relates to its projected liabilities and not just to those liabilities already accrued.

Finally, this proposal begins to address the growing and very real problem of unfunded retiree health liabilities. They currently exceed $100 billion, approximately $45 billion of which relates to current retirees.

In summary, the administration's proposal is a response to a series of disturbing trends that Mr. Mentz alluded to and it would

improve the benefit security of America's workers, the ultimate intended beneficiaries of the private pension system.

The administration believes that a comprehensive revision of the termination and funding-related provisions of ERISA represents the only responsible and viable means to lessen the number of underfunded plans and the extent of underfunding. As a result, this would avoid, or at least minimize, losses that are imposed on plan participants and, in certain cases, transferred to the PBGC. In addition, the health provisions will help to ameliorate the problem of unfunded health benefits, a very real one which is of concern to this administration.

Now, in approaching these and other problems identified in the proposal, the administration adhered to several policy objectives and principles that I would like to briefly enumerate.

First, the termination and funding rules of ERISA must be structured to provide reasonable assurance that all private pension plan participants will receive their full promised benefits.

Second, employers should be free to make their own pension promises, either directly or as a result of the collective-bargaining process. However, once a promise has been made, an employer should be held fully responsible and accountable for keeping the promise.

Third, employers should be given neither incentive nor opportunity to make pension promises that exceed their liability for those promises or that exceed their financial capacity to discharge them when they come due.

Fourth, employers should not be able to impose essentially avoidable losses on plan participants or the PBGC.

Fifth, the minimum funding rules of ERISA should be amended to encourage optimal, rather than excessive or deficient, funding of pension promises.

Sixth, employers should not be required to retain funds in a plan that are clearly in excess of the amount needed to provide a reasonably high degree of assurance that all pension promises will be kept; that is, assets that exceed the full funding level of the plan.

Seventh, government policy should serve to encourage employers to provide retiree health benefits in ways that do not involve significant additional tax expenditures.

Now, on the basis of these policy objectives, let me summarize and review the key elements of the proposal:

The tighter minimum funding standards will, in the long run, decrease the number of underfunded plans and the extent of underfunding. They will enhance the benefit security of participants and reduce the PBGC's financial exposure.

Increasing an employer's liability to participants to the level of a plan's termination liability will serve to increase the level of benefits participants actually receive in standard and distress termination and will encourage sponsors to fund all their plans adequately.

The adoption of the proposed controlled group concept for withdrawals, reversions, minimum funding waivers, and the definition of liability will increase the likelihood that participants will receive their full accrued benefits and, importantly, will significantly reduce the PBGC's financial exposure.

Allowing withdrawals from ongoing plans with appropriate cushions and other restrictions in lieu of transactions currently allowed under the implementation guidelines will serve to provide for a more stable and secure private pension system. It will increase the chances that future accruals will be funded properly and that participants will receive future benefit increases.

Finally, permitting employers to make certain tax-free transfers to fund health benefits for current retirees will encourage employers to continue to provide these important benefits and, as a result, will enhance retirement security and, in turn, reduce the ultimate burden that may be imposed on public programs.

In final summary, the major benefits of the proposal are: First, to offer stronger protections for the retirement income security of American workers; second, to reduce prospectively the financial claims on the PBGC; third, to increase the likelihood that retirees will continue to receive employer-provided health insurance and serve to encourage additional employers to provide that kind of coverage; and, last, the proposal will enhance overall economic competitiveness by promoting capital mobility.

Mr. Chairman, that concludes my opening remarks.

Chairman PICKLE. Mr. Kass, I thank you for your statement.

I noticed that you were reading from a statement. Have you submitted a statement to the committee outlining the position of the Department of Labor?

Mr. KASS. I have not, sir. The administration has just one prepared statement. These are some jotted-down remarks. I would be happy to make them available to you, sir.

Chairman PICKLE. I know Mr. Mentz has made a statement. Is that the proposal that we have? Is that the administration statement?

Mr. KASS. Yes. Anything I said is what he said.

Chairman PICKLE. Then I don't need to have you here, then.

Mr. KASS. That is very kind of you, sir.

Chairman PICKLE. Or the rest of you, in a sense. What I am getting at is, why is it we don't have a statement from you, a written statement from you, Mr. Kass, and from Dr. Utgoff and Mr. Posner?

Mr. MENTZ. Mr. Chairman, what we envisioned was that we would have one combined statement, that I would make it, and that the others—Dennis, Kathy, Bill—are expert in various aspects of the proposal, more so than I, and that they would be available to answer questions, and then, as I indicated to you——

Chairman PICKLE. Mr. Mentz, I don't want to belabor this point, but who decided you wouldn't have a statement for the committee, the rest of you wouldn't have a statement? Who decided that?

Mr. MENTZ. Well, I think what we decided collectively—I will take responsibility for it—was that I would make the statement on behalf of the administration and that these three would be available to answer questions without making a formal statement. And then, when we discussed it earlier, you suggested that——

Chairman PICKLE. Well, but Mr. Kass is reading a prepared statement to us, but he will not give our committee a copy of his prepared statement.

Mr. KASS. Oh, no, sir. I would be happy to do that. In all candor, we understood that the administration was being asked to submit a statement. The statement given by Mr. Mentz——

Chairman PICKLE. Now, let's quit fencing around here.

Mr. KASS. All right, sir.

Chairman PICKLE. Were you directed by the OMB not to submit a statement to us?

Mr. KASS. Oh, no, sir. However, it would have—I mean, you did ask us to——

Chairman PICKLE. I understand that is kind of what has been done, and I am not going to belabor this point because it is not that important to this hearing. But I am saying to each of you witnesses, you were asked for a written statement. I want to know how it affects your agency, not just what the administration is making their proposal.

Mr. Mentz has made a proposal and has made a good one. I am glad you have done so, and I think it gives us a good start. But if each of you people representing the Department of Labor and representing PBGC would just say you are here just representing the Treasury and you don't have a statement of your own other than to verbally state it, I think it is outrageous. I think you all should give us a statement, and I say to you, you give us a written statement if you want to give us one, and I say that to the others just as a matter of policy.

Mr. KASS. We will follow up on that, sir, and provide it to you.

[The following was subsequently received:]

U.S. Department of Labor

Assistant Secretary for
Pension and Welfare Benefits
Washington, D.C. 20210

March 11, 1987

MAR 18 1987
RECEIVED
MAR 17 1987
Ways and Means
Subcommittee on Oversight

The Honorable J. J. Pickle, Chairman
Subcommittee on Oversight
of the Committee on Ways and Means
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

It was a privilege for me to have the opportunity to appear with other members of the Administration on Friday, March 6 before the Subcommittee on Oversight of the Committee on Ways and Means.

The statement delivered by Roger Mentz of the Treasury Department was the result of a collaborative drafting and clearance process by the four agencies involved. However, let me again apologize for the apparent misunderstanding regarding the Committee's desire for a separate written statement from the Department of Labor. As you requested, I am submitting the text of my opening remarks for the Committee record, and of course, would be pleased to comment in writing on any other matters of interest to you in connection with the Administration's Proposal on the Funding and Termination of Defined Benefit Pension Plans.

I hope this information is useful to you, and look forward to working with you in making this important legislative initiative successful.

Sincerely,

Dennis M. Kass
Assistant Secretary

Enclosure

STATEMENT OF
DENNIS M. KASS, ASSISTANT SECRETARY
PENSION AND WELFARE BENEFITS ADMINISTRATION
U.S. DEPARTMENT OF LABOR
AT THE HEARING OF THE SUBCOMMITTEE ON OVERSIGHT OF THE
COMMITTEE ON WAYS AND MEANS
MARCH 6, 1987

The Department of Labor (PWBA) has primary responsibility for protecting the retirement income security and other benefit entitlements of the millions of Americans covered under private pension and welfare benefit plans. As such, my remarks will focus on the proposal's effect on the benefit security of plan participants and the integrity of the overall private pension system.

The submission of this proposal fulfills the responsibility of the Secretary of Labor, as set forth in SEPPAA, to report to the Congress our legislative recommendations concerning reversions of residual assets from terminated overfunded defined benefit plans. Secretary Brock has had a long standing personal commitment to legislation in this area, and has spearheaded the Administration's development of the proposal now before Congress.

The primary objectives of the proposal are to:

1. Make more secure the retirement benefits of the nearly 35 million American workers who are covered by single-employer defined benefit pension plans, and

2. To reduce the financial burdens imposed on the Pension Benefit Guaranty Corporation (PBGC).

o Underfunded Plans

Underfunded plans result in:

- o Workers not receiving their full accrued benefits; and
- o Massive and growing liabilities for the PBGC.

o The Administration believes that many of the losses being imposed on plan participants and the PBGC are due to weaknesses in the current

termination and funding provisions of ERISA and are avoidable.

- While in general pension plans are well funded, currently there is approximately $45 billion in underfunding (on a termination basis). In fact, the funding status of some plans has deteriorated despite compliance with ERISA's minimum funding standards. As a result, fundamental changes in the termination and funding related provisions of ERISA are necessary in order to avoid, or at least minimize the inappropriate imposition of future losses on plan participants and the PBGC.

- Overfunded Plans

  - There is currently approximately $263 billion of overfunding (on a termination basis). While overfunded plans do not represent an immediate threat to participants' benefit security, there are inadequacies in current law which need to be addressed. Specifically, under current law the only means of obtaining access to any surplus that may accumulate through favorable investment experience or additional contributions is through plan termination. Such terminations are costly, disruptive, and can have an adverse effect on the future benefit security of plan participants. Also, these terminations and asset reversions may decrease the extent or likelihood of any future benefit increases or ad hoc cost of living allowances for retirees.

  - Under current law, sponsors may obtain all assets in excess of termination liabilities after satisfying certain conditions (eg., notice, vesting, annuitization) and continue to cover their active employees under defined benefit plans. Some of the assets removed from what are, in effect, "ongoing" plans in transactions that are now allowed, should in fact remain in the plans to fund promised benefits.

  - As a result, workers may be subject to greater exposure to future market declines. In addition, current law relating to asset reversions ignores the fact that an ongoing plan's funding target relates to its projected

liabilities (i.e., future salary increases, but not service) and not just to those liabilities already accrued.

- Retiree Health Benefits

  - Finally, the proposal also begins to address the growing problem of unfunded retiree health liabilities, currently in excess of $99 billion, approximately $45 billion of which relates to current retirees.

- Summary

  - The Administration's proposal comes in response to these trends and would improve the benefit security of America's workers, the ultimate intended beneficiaries of the private pension system.

  - The Administration believes that a comprehensive revision of the termination and funding related provisions of ERISA (relating to both under and overfunded pension plans) represents the only viable means to lessen the number of underfunded plans and the extent of underfunding, and as a result to avoid or at least minimize any losses being imposed on plan participants and the PBGC. In addition, the (retiree) health provision will help to ameliorate the problem of unfunded health benefits.

- POLICY OBJECTIVES AND PRINCIPLES OF THE PROPOSAL

  - In approaching these and other problems identified in the proposal, the Administration adhered to the following policy objectives and principles:

    - The termination and funding rules of ERISA must be structured to provide reasonable assurance that all private pension plan participants will receive their full promised (accrued) benefits.

    - Employers should be free to make their own pension promises, either directly or through the collective bargaining process; however, once a promise has been made, an employer should be held fully responsible and accountable for that promise.

- Employers should be given neither incentive nor opportunity to make pension promises which exceed their liability for those promises or their financial capacity to discharge them when due.

- Employers should not be able to impose essentially avoidable losses on plan participants or the PBGC.

- The minimum funding rules of ERISA should be amended to encourage optimal rather than excessive or deficient funding of pension promises.

- Employers should not be required to retain funds in a plan which are clearly in excess of the amount needed to provide a reasonably high degree of assurance that all their pension promises will be kept.

- Government policy should serve to encourage employers to provide retiree health benefits in ways which do not involve significant additional tax expenditures.

- KEY ELEMENTS OF THE PROPOSAL WHICH WOULD SERVE TO ENHANCE BENEFIT SECURITY

  - The tighter minimum standards will, in the long run, decrease the number of underfunded plans and the extent of underfunding. They will enhance the benefit security of participants and reducing PBGC's financial exposure.

  - Increasing an employer's liability to participants to the level of a plan's termination liability will serve to increase the level of benefits participants will receive in a standard or distress termination and will encourage sponsors to fund all their plans adequately.

  - The adoption of the proposed controlled group concept for withdrawals/reversions, terminations, funding, waivers, liabilities, deductions, etc., will increase the likelihood that all plan participants will receive their full accrued benefits and will significantly reduce PBGC's financial exposure.

- Allowing withdrawals from ongoing plans with appropriate cushions and other restrictions in lieu of "Guidelines" transactions will serve to provide for a more stable and secure private pension system. It will increase the probability that future accruals will be funded properly and that participants will receive future benefit increases.

- Permitting employers to make certain tax free transfers to fund health benefits for current retirees will encourage employers to continue to provide these important benefits, thereby enhancing retirement security and reducing the ultimate burden which may be imposed on the government (eg., Medicare and Medicaid).

- MAJOR BENEFITS OF THE PROPOSAL

  - Offers stronger protection for the retirement income security of American workers.

  - Prospectively will reduce the financial claims imposed on the PBGC insurance system.

  - Increases the chances that retirees will continue to receive employer provided health insurance and will serve to encourage additional employers to provide such coverage.

  - Enhances overall competitiveness by promoting capital mobility.

Mr. KASS. But I cannot overemphasize that this proposal represents the joint efforts of the Treasury and——

Chairman PICKLE. I am glad for that, but I also cannot overemphasize the fact that this committee expects a written statement. When you come here to make a statement, I want a copy of your written statement, and I don't want you to be directed not to make one. If you are going to be so instructed, I don't want you up here before this committee.

Well, excuse me, but I am just trying to express a personal view.

Mr. Thomas?

Mr. THOMAS. Thank you, Mr. Chairman.

Perhaps the three other individuals should have sat in chairs behind Mr. Mentz as we normally do with people who are to supply expertise in particular areas. It is, however, fairly unusual for the people sitting in the chairs behind the testimony desk not to be of the department of the individual offering the testimony. So we have a different situation in that the expertise is spread across several departments. I think that it is pretty obvious that this particular presentation is a broad and comprehensive one.

Mr. KASS. Thank you, sir.

Chairman PICKLE. Now, Dr. Utgoff, do you have a statement to make?

Ms. UTGOFF. No, I did not come prepared to make a statement, but I do have remarks to make if you would like about the specific effect of the proposal on the PBGC.

Chairman PICKLE. Mr. Posner, do you have a statement to make?

Mr. POSNER. No, Mr. Chairman, I don't have a statement to make. My understanding was that the committee was interested in the waiver process of the IRS and also its process for terminating plans, and I can make some remarks about that if you wish.

Chairman PICKLE. Well, I am going to ask Dr. Utgoff to proceed to make such statement that comes to mind that you would like to present to us and for us to be edified about, and I say that somewhat facetiously, but I also say that OMB does not run the Oversight Subcommittee, and I see nothing but correct procedure to follow. If you are going to make a statement, give us a written statement. I want to know how it affects your department and not how it just affects, quote, the administration per se. You surely should be prepared to do that.

Dr. Utgoff, go ahead and make such statement as you wish now.

STATEMENT OF DR. KATHLEEN UTGOFF, DIRECTOR, PENSION BENEFIT GUARANTY CORPORATION

Ms. UTGOFF. I am sorry for the misunderstanding, Mr. Chairman, but I would just like to say that——

Chairman PICKLE. Dr. Utgoff, you don't have a prepared statement and what you are saying now is not being heard. [Laughter.]

Ms. UTGOFF. Excuse me. Is that better?

Chairman PICKLE. That is a little better.

Ms. UTGOFF. Of course, the PBGC has a vital interest in the proposal that Roger Mentz described today and, in particular, the changes in the minimum funding standards are crucial to make

sure that the PBGC does not face the huge and unwarranted claims that we have in the last year or so.

The current minimum funding standards do not ensure any kind of sound funding, and in fact we have faced circumstances where they do not ensure even plan solvency. In other words, some plans that were in complete compliance with the current minimum funding standards ran totally out of money. If there is a better definition of unsound funding, I don't know of one.

Let me just describe, so that you understand the nature of the problem that we are facing and how serious it is, some of the cases that have come before the PBGC since I became executive director.

One of those is Allis-Chalmers, which I have talked to you about before in previous testimony. Under this plan, contributions were made in all years at or above ERISA minimum funding, and there were no waivers obtained. I have talked before about waivers, but this is not a case where there were any waivers.

Yet the plan ran out of money and we were forced to take it over when it had only one month of benefits left and $170 million of underfunding in the plan.

Another case: The LTV Republic salaried plan. They again had no waivers and they met current minimum funding standards. And yet, when we were forced to step in, as required by law, they had $7,700 in assets available to pay $2 million of monthly benefits, and the total underfunding in the plan was $230 million. Absolutely no money was available to pay benefits; yet the plan was in complete compliance with the minimum funding standards.

Again, just this week, Kaiser Steel's salaried plan terminated with no assets and monthly benefits of $176,000, less than the other cases but still significant, and unfunded guaranteed benefits of $27 million. And in this plan they had routinely purchased single-premium annuities for employees eligible for retirement, which had a great drain on the plan's assets.

So these cases, in a very real way, have made it clear to us that if the agency is to continue in its mission to protect pension security, the minimum funding standards have to be changed. Roger Mentz just described a proposal that will do that, and that is why we are vitally interested in that.

Thank you, Mr. Chairman.

Chairman PICKLE. Thank you, doctor. Does that complete your statement?

Ms. UTGOFF. I have a list of terminations with me; that is all I have.

Chairman PICKLE. You have what?

Ms. UTGOFF. I simply have a list of our bigger terminations.

Chairman PICKLE. Mr. Posner?

STATEMENT OF WILLIAM POSNER, ASSISTANT DIRECTOR, EMPLOYEE PLANS TECHNICAL AND ACTUARIAL DIVISION, INTERNAL REVENUE SERVICE

Mr. POSNER. Thank you, Mr. Chairman.

I would like to take this opportunity if I might to describe to you the IRS experience in processing waiver cases and also termination cases.

As you know, the minimum funding standards involve a waiver process for companies that face substantial business hardship. In a funding waiver, a company must show that a substantial business hardship exists, that the application of the funding standards would be adverse to the interests of participants——

Chairman PICKLE. Mr. Posner, would you move the microphone closer to you? Thank you.

Mr. POSNER. Yes.

Chairman PICKLE. Just get up close to it. It helps.

Mr. POSNER [continuing]. That the application of the funding standards would be adverse to the interests of participants and that it is reasonable to expect that the plan will be continued if a funding waiver is granted.

Under the current law, funding waivers can be obtained as many as five times in 15 years, and the waived amounts must be amortized over not more than 15 years. A company that wants a funding waiver must make application to the national office of the Internal Revenue Service in accordance with published procedures. The application includes the financial data of the employer and a description of the hardship and a description of the potential for recovery.

Under current law, when we receive an application for a waiver, if the waiver request is for over $2 million, we forward a copy of the application and materials to the PBGC for comment. If the waiver is under the $2 million, we inform the PBGC of the fact that there was a waiver request, and if they are interested in commenting on the waiver, they let us know.

I want to emphasize that we coordinate very closely with the PBGC, particularly on large waiver cases, and when we meet with companies concerning their waiver application, particularly in the large cases, PBGC often attends.

When a final decision is made, it is very often made in close coordination with the PBGC. If the PBGC needs security to protect its interests and the IRS concurs, the security is made a condition of the waiver and the PBGC perfects the lien.

Whenever a waiver is denied, a copy of the denial is sent to the appropriate IRS district office so that an excise tax on the funding deficiency may be assessed.

Currently, we receive between 300 to 400 funding wavier requests a year, which is about the same rate as the late 1970's and down from a high of about 1,000 requests in 1983.

I would like to describe to you very briefly some of the administrative problems that we have encountered in processing waiver cases. Under current law, there is no cutoff date for requesting a funding waiver. Some companies have not requested a funding waiver until the IRS uncovered a funding deficiency and proposed a large excise tax penalty.

Before assessing these taxes, IRS must then look at the merits of a funding waiver request that the company then makes. This encourages some companies to play the audit lottery, diminishes participant protections, and increases the insurance risk to the PBGC.

The proposed legislation establishes a cutoff date of 2½ months after the end of the plan year for a company to request a waiver.

Other companies cite as a reason for a waiver the need to use the money for expansion or capital improvements. Rather than attempting to get funds through the commercial loan process, these companies request a funding waiver.

The legislative proposal raises the interest rate for paying back the funding waiver to what is a market rate for distressed companies.

Another problem is that sometimes a company with a temporary hardship that is part of a controlled group requests a waiver. Overall, the controlled group is profitable and could well afford to make the funding contribution. However, under current law, the waiver would be granted because only the company maintaining the plan is responsible for the funding of that plan.

Mr. THOMAS. Mr. Chairman, could I interrupt Mr. Posner?

Chairman PICKLE. Mr. Thomas?

Mr. THOMAS. How do you define controlled group?

Mr. POSNER. Well, a controlled group is a defined term under the code and includes brother-sister corporations, parents, subsidiaries, and the like.

Mr. THOMAS. Thank you.

Mr. POSNER. At any rate, the proposed legislation remedies the problem by making the entire controlled group responsible for the minimum funding contribution.

As far as the IRS processing of asset reversion cases is concerned, this is done by our local IRS district offices. Employers who terminate their plan and want a determination letter regarding the plan's qualified status must file an application for such a determination.

The application form provides information necessary for the Service to determine whether the qualification standards are met. These standards include the asset reversion guidelines that were jointly issued by the Treasury Department, the Department of Labor, and the PBGC in May 1984.

Because termination cases represent a last chance to view the plan, the determination letter cases are handled by our district offices on a priority basis. In addition, under the Service's examination program, certain terminated plans are targeted for examination.

Now, obviously, under current law there are problems with excess-asset cases, and these have been described by Mr. Mentz and the proposed legislation that addresses them, and we certainly support that. Our field offices, though, under current law, have indicated to us that there are not any significant administrative problems in handling the cases.

That concludes my remarks. I would be happy to answer any questions.

Chairman PICKLE. Well, I thank you.

Now, first, I want to say to you, Mr. Secretary, that I think you have made a very substantial, worthwhile proposal, and it will receive our serious consideration. I appreciate the initiative you have shown and the cooperation you have shown.

Mr. MENTZ. Thank you, Mr. Chairman.

Chairman PICKLE. I speak personally now that I do not appreciate the fact, though, that the other witnesses have come here read-

ing from prepared statements but refused to give our committee a written statement in advance. I will not permit that again, and to whomever that should be told, I hope you will relay that information.

I am disturbed that Mr. Posner has just made a statement about the IRS and what part they play, and I have difficulty following or really understanding or being able to later study it, other than what you have said verbally.

I want to know, for instance, what has been IRS's process in granting waivers of the minimum funding rule and the process following assets reversions. I want to know what part the IRS played in giving data to the administration in advancing the plan. I presume that you, IRS, must give them a lot of information that would be necessary in the development of the plan that they have now proposed because you are the only ones that have a lot of the data, I presume.

Now, you have just said there are a lot of administrative problems. But, as far as I am concerned, I have just a general feeling of what those problems are, and I do not have a chance to examine them. So I ask you, sir, will you submit a written statement to us about these matters and this information that I am asking for?

Mr. POSNER. I would be happy to, Mr. Chairman.

Chairman PICKLE. All right.

[The following was subsequently received:]

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

AUG 27 1987

The Honorable J.J. Pickle
Chairman, Subcommittee on
Oversight
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

This is in reply to your request for information concerning the Administration's proposal to reform funding and the termination of overfunded defined benefit pension plans that was discussed at a Hearing before your Subcommittee on Friday March 6, 1987. In recent conversations with Ms. Beth Vance, Staff Director for the Subcommittee on Oversight, we were asked to respond to the following matters.

First, we were asked for information on how the IRS processes requests for waivers of the minimum funding standards and what our experience has been in this area.

The minimum funding standards include a waiver process for companies facing a temporary business hardship. In order to obtain a funding waiver for a plan, the company must show that a substantial business hardship exists, that applying the funding standards would be adverse to the interests of the plan participants and that it is reasonable to expect that the plan will be continued if a funding waiver is granted.

Funding waivers can be obtained from the IRS as many as five times in a 15 consecutive-year period. Any waived amount is required to be contributed to the plan through annual amortization over not more than 15 years.

A company that wants a funding waiver must make an application to the National Office of the IRS in accordance with a published procedure, Revenue Procedure 83-41, 1983-1, C.B. 775, which describes how this must be done. The application must contain information on 1) general facts concerning the company (e.g. its history, ownership, etc.); 2) the financial condition of the company; 3) a description of the nature and extent of the business hardship that is the reason for the request; and 4) a statement concerning the prospects for recovery, including reasons why such recovery is likely.

When the IRS receives an application for a waiver, if the request is for over $2 million, we forward a copy of the application and accompanying materials to the PBGC for comment.. The PBGC has 30 days to comment. If the waiver request is for less than $2 million, we inform the PBGC that a request was made and the PBGC informs us if they interested in the waiver.

The IRS works very closely with the PBGC in developing the cases, particularly on large waiver cases, and when we meet with the representatives of the companies concerning their waiver applications, the PBGC attends the conferences.

When a final decision is made on a large waiver case, it is made in close coordination with the PBGC. If, in a particular case, the PBGC advises us of the need for a security interest with respect to the amount waived and the IRS agrees, the requirement of a security interest is made a condition of the funding waiver and the PBGC perfects the lien.

If a waiver is denied, a copy of the denial letter is sent to the appropriate IRS district office so that the IRS can assess an excise tax of 5 percent on the amount of the funding deficiency. If the funding deficiency is not corrected so as to reduce the amount of the deficiency to zero, the IRS may assess an excise tax of 100 percent of the uncorrected amount of the funding deficiency.

Currently the IRS receives between 300 to 400 funding waiver requests a year which is about the same rate as in the late 1970's. This is down from a high of about 1,000 requests in 1983. For the fiscal year beginning October 1, 1986 to July 30, 1987, the IRS has received 287 waiver requests.

In processing these requests, the IRS looks closely at such items as the possibility for recovery from the business hardship occasioning the request, and the sufficiency of security so that there will not be an unacceptable risk to the PBGC.

Certain concerns have arisen in connection with this process, and the IRS has provided technical input to the Administration's proposals to deal with these concerns. Specifically we identified five problem areas all of which were addressed in the Administration's proposals in a way that would eliminate the current problems.

(1) The waiver of minimum funding standards is intended to be a temporary measure to mitigate the impact of the funding requirements where it would otherwise result in hardship. The assumption is made that the the company will recover and continue funding the plan. The current law, however, does not state specifically that the hardship is temporary or call for recovery within a specific period of time. The Administration's proposal would clarify the intent of the law and make specific the requirement that the hardship is temporary and that recovery is expected in the near future.

(2) The second problem concerns members of a controlled group of companies, as defined in subsections 414(b) and (c) of the Code. A particular unprofitable subsidiary may have an underfunded plan, and request a waiver, while the controlled group as a whole has more than sufficient funds.

Under the Adminstration's proposal, all members of the controlled group containing the plan sponsor would be liable under the minimum funding rules. Therefore, business hardship would be based upon the circumstances of the entire controlled group, rather than merely the circumstances of the employer maintaining the plan.

(3) A third problem encountered by IRS in dealing with minimum funding waivers concerns the 8 1/2 month period which plans have for contributions to satisfy the minimum funding requirements. The problem is two fold. On the one hand, a company, at the end of the plan year may have sufficient money to make the required contribution. It does not do so at the time, and 8 1/2 months later, the company has incurred losses and claims it is now in no position to make the contribution. On the other hand, a company may have a loss at the end of the plan year, and based on hardship at that particular time, request a waiver of the minimum funding requirement. The company may have recovered economically 8 1/2 months later, and in fact be in a position to make the required contribution, but the application for a waiver is based on a hardship situation that may no longer exist. To deal with this problem, the Administration's proposal would require contributions to be made quarterly (similar to estimated tax payments), and the total required contributions for a plan year would have to be made within 2 1/2 months after the close of the plan year.

(4) A fourth problem the IRS has encountered is the time for requesting waivers. The law does not provide a deadline for submission of waiver applications. The IRS administratively allows a request to be made up to one year after the end of the plan year, with discretion to allow a longer period for reasonable cause. Since there is no incentive to timely submit waiver requests, some companies wait until the IRS has uncovered a large funding deficiency before requesting a waiver. Other companies claim

that a change in management, accounting practices, or other reasons have led to the late request. The IRS may appear to be arbitrary or capricious in enforcing a period of time for the waiver submission for which there is no requirement in law. The Administration's proposal would require applications for minimum funding waivers to be submitted within 2 1/2 months after the end of the plan year.

(5) A fifth problem is with companies that have sufficient funds to make the required contribution but instead request a waiver of the minimum funding standards in order to use the money for business expansion or for capital improvements rather than attempting to get funds through the commercial loan process. To discourage this practice, the Administration's proposal would increase the interest rate required on waived contributions to the market rate for loans to distressed companies.

Additionally, you have asked for information on how the IRS processes asset reversion cases and what problems if any the IRS has encountered in this area.

The IRS processing of asset reversion cases is done by local IRS key district offices (offices where there are personnel responsible for employee plans matters). A company that terminates its plan and wants a determination letter regarding the plan's qualified status will file an application for such a determination.

The application form (Form 5310) provides information necessary for the IRS to determine whether the qualification standards are met. These standards include the asset reversion guidelines that were jointly issued by the Treasury Department, the Department of Labor and the PBGC in May 1984.

A termination case represents the last chance for the IRS to review the plan. These cases are handled by our key district offices on a priority basis over other determination letter cases. In addition, under the IRS's examination program, certain termination cases are targeted for examination.

Under current law, there are a number of problems with excess asset reversion cases. These problems were described at the Hearing by the Assistant Secretary for Tax Policy. The IRS provided technical assistance to the Treasury Department and the other ERISA Agencies in the development of the Administration's proposals and is in agreement with the proposed legislation that addresses these problems.

As indicated at the Hearing, in general, IRS field offices have indicated to the National Office that they have not encountered any significant administrative problems in handling excess asset reversion cases. However, subsequent to the Hearing, two courts rendered decisions in, B.E. Tilley, et. al. v. The Mead Corporation, 815 F. 2d 989 (4th Cir. 1987), and Blessitt v. Dixie Engine Co, 817 F. 2d 1528 56 U.S.L.W. 2043 (11th Cir. 1987), that may impact on plans with excess assets. The IRS has temporarily suspended issuance of determination letters on reversion cases by key district offices within the jurisdiction of the 4th and 11th circuits in order to allow us to assess the impact of these decisions.

I hope this information will be of assistance to you.

Sincerely yours,

William Posner

William Posner
Assistant Director,
Employee Plans Technical
and Actuarial Division

Chairman PICKLE. I will follow through with any other statement to the Internal Revenue Service that needs to be made. The same is true, Dr. Utgoff, of your agency and the Department of Labor. I want to know.

You mentioned, Dr. Utgoff, a lot of these plans that are going under, and have said that this really should not be permitted—the Wheeling Pittsburgh or the LTV case—and you may be correct.

As I recall it, though, a year ago, when we had these hearings, I did not have any recommendation of any plans for changes to the plans per se but rather just to raise premiums. All you recommended to me is to raise premiums.

Let me ask you generally, none of you commented at all about what the premiums will be. Do you avoid that purposely, or will that depend a great deal on what develops? Why has no mention at all been made of the premiums? Dr. Utgoff, do you think we ought to raise the premiums now?

Ms. UTGOFF. Yes.

Chairman PICKLE. How much?

Ms. UTGOFF. The administration, as part of the budget process this year, has proposed a variable-rate premium structure which will raise additional revenue for the PBGC. That will be submitted as a separate proposal.

We were under the understanding that we were to come here to describe the administration's overfunding and underfunding proposal, which does not include the variable-rate premium.

Chairman PICKLE. That is understandable. We are also faced with this fact, that we have got $4 billion of unfunded liability at PBGC at this point.

Ms. UTGOFF. Yes.

Chairman PICKLE. If that situation continues or gets worse, from an immediate standpoint, we would have no options perhaps except to raise the premiums. Do you recommend any increase in premiums at this point?

Ms. UTGOFF. The administration will submit a proposal which will, in effect, raise additional revenue for the PBGC, but it will not be another flat-rate premium increase. It will be an increase in the premium for underfunded plans.

Chairman PICKLE. Do we anticipate that any time soon?

Ms. UTGOFF. Yes, very soon.

Chairman PICKLE. How soon?

Ms. UTGOFF. Within the next month or so.

Chairman PICKLE. Mr. Thomas?

Mr. THOMAS. On that point, Mr. Chairman, help me understand why you are not willing to talk about a variable-rate premium which is designed to help alleviate the problems with an underfunded pension program as part of the discussion on overfunded and underfunded pension plans.

Ms. UTGOFF. The decision was made to separate the two——

Mr. THOMAS. Who made the decision?

Mr. KASS. Secretary Brock.

Mr. THOMAS. All right. I don't want to go off on that tangent, but why is this part of a competitiveness plan if what makes them viable is a variable-rate premium? You separated them into two categories which does not make sense to me.

Mr. KASS. May I comment on that, Mr. Thomas?

Mr. THOMAS. Sure.

Mr. KASS. Thank you.

The purpose of this proposal is to strengthen the integrity of the pension system, the funding of the pension system that provides benefits to workers. The purpose of the variable-rate premium proposal is to improve the financial condition of the Pension Benefit Guaranty Corporation. These are complementary concerns, but I think there is a distinction to be made between them.

Mr. THOMAS. And is it also possible that the work on the variable rate was not finished and you wanted to make it part of a competitive package.

Mr. KASS. Yes. They were on different calendars.

Mr. THOMAS. All right. Thank you.

Thank you, Mr. Chairman.

Chairman PICKLE. I think we will proceed to ask some questions on some of the various subjects that have been touched on. I guess we will just jump around a little bit on our questions to try to find out a little bit more what you have proposed, in the absence of getting a statement from you.

In the question of the pension plans, on the stricter minimum funding standards, you are going to move up the amortization period very rapidly, 3 to 5 years as compared to the, what, 20 or 30 years. What is the rationale for the stated minimum amortization plan, moving it up to 3 to 5 years? What is the rationale on that?

Mr. MENTZ. Well, Mr. Chairman, it is not moved up to 3 to 5 years in every case. There would be a mathematical formula that would accelerate the funding in cases where the liabilities have a shorter maturity point, so that if a plan has very long-range liabilities, there may not be any acceleration of the funding.

But there is a formula that varies the rapidity of the funding depending upon the time at which the liabilities become due. Three to 5 years I mentioned as the most rapid, most accelerated form of funding. It would not be contemplated that that would be the funding in every case, or probably in very few cases.

Mr. KASS. May I briefly add to that, Mr. Chairman?

Chairman PICKLE. Mr. Kass?

Mr. KASS. There will be no acceleration of funding for plans that have assets actuarially determined that are equal to or in excess of 110 percent of termination liabilities. So this acceleration is going to affect not all plans but plans that are underfunded.

In respect to plans that are underfunded, as Mr. Mentz points out, how rapid or I should say how sharp the acceleration of the amortization table will be will be a function of how well funded the plan is and how soon those liabilities fall due. The rationale, in answer to your opening question, is to be sure there is money in the bank to pay the benefits when the benefits fall due.

Mr. THOMAS. Mr. Chairman, would you yield on that point?

Chairman PICKLE. Yes.

Mr. THOMAS. In the proposal that you have submitted, at page 11, you talk about the amortization period for any particular plan would range from a minimum of 3 to 5 years on up. You say that the older the plan participants and the more benefits are attributable to past service, the greater the maturity of the plan's liabilities,

then the applicable amortization period will be shorter. Then you say, "It is expected that the amortization periods for many of the plans subject to this rule would not be shortened," and you just made that statement.

Mr. MENTZ. That is right.

Mr. THOMAS. Then you say, "The determination of the applicable amortization period for a plan's existing unfunded liability would be made either by direct application of a prescribed formula or by reference to a table that would be developed to show the applicable amortization periods."

How do you make those statements if you have not developed the tables? On what basis do you make the statement it is 3 to 5 years? On what basis do you make the statement that most of the plans would not be shortened if you have not developed these tables by which you are going to determine it? And did you have a hypothetical model? On what basis did you run data through to make these assumptions?

Chairman PICKLE. And wasn't it your intent to shorten this time on nearly every one of them, in most instances?

Mr. MENTZ. Well, the 3 to 5 years is a cutoff. We are saying we are not going to accelerate the funding faster than 3 to 5 years. That is the recommendation.

Mr. THOMAS. So that was just a kind of arbitrary policy decision?

Mr. MENTZ. Right.

Mr. THOMAS. You use that as a floor and then figure out where you are going?

Mr. MENTZ. Yes. Now, in terms of how it works mathematically, we have a formula in mind. It is not in my testimony. It is fairly arcane, but there is a formula in mind that would reflect the maturity of the benefit liabilities versus the funds already in the plan and come out with a level of funding acceleration.

Now, in order to do the table, you have got to project that out. Doing the table is a little bit more than mechanical, but it is basically a projection of what this formula would show.

We have the proposal conceptually together, but it is not mechanically all worked out, and I would expect this to be a very serious part of the proposal that would involve, certainly, the interplay of the Ways and Means Committee and the Senate Finance Committee, and the labor committees. And there will be some give and take. But, conceptually, we have a formula in mind, Mr. Thomas.

Mr. THOMAS. Mr. Chairman, on that point then, could we have the administration submit within a reasonable time frame, a couple or 3 weeks, what its formula is upon which you made the statements in the proposal?

Mr. MENTZ. Sure.

Mr. THOMAS. There may not be an amortization table, but obviously, you have looked at data which allowed you to make some parameter-setting statements about what you will or will not be doing. Is that possible?

Mr. MENTZ. Sure, we will be glad to get you that, Mr. Thomas.

Mr. THOMAS. Thank you.

[The information was not received.]

Mr. KASS. One other comment. I would not want to leave the mistaken impression that all of the liabilities of a plan may be am-

ortized over a 3-year period. There are different amortization schedules that are applied to different types of liabilities.

Just to continue that point, one might expect that the amortization for the various liabilities of a plan will range from 3 to 30 years, the current amortization basis, that will probably produce a weighted-average duration of in the neighborhood of 10 to 12 years for an underfunded plan. So just an important cautionary note that we are not talking about accelerating to 3 years all of the liabilities of a plan.

Thank you, sir.

Chairman PICKLE. But if you have this amortized approach, as a practical matter, how many of these plans, or what percentage of these plans, would you expect you would terminate rather than meeting the restricted funding standards? Isn't that going to be a question we have to balance?

Mr. MENTZ. I think it is important to look at that.

Dr. Utgoff, can you help?

Ms. UTGOFF. I think it crucially depends upon the transition——

Chairman PICKLE. Dr. Utgoff, I have a little difficulty hearing.

Ms. UTGOFF. I am sorry, Mr. Chairman.

Chairman PICKLE. You are talking up and the microphone is going the other way.

Ms. UTGOFF. There will be every effort made in finishing out the details of the proposal to make sure that it does not cause any undue hardship for plans that are now seriously underfunded and cause a termination that would not otherwise have occurred. So it will crucially depend upon the transition rules, which we are still working on.

Chairman PICKLE. Have you got any way to determine how much extra money your proposal would require employers to put in these plans?

Ms. UTGOFF. It will depend very much on the plan-by-plan circumstances. Some plans that have a high ratio of retired workers with recent benefit increases, particularly those that offer lump-sum payments, after the transition rules are worked through and the proposal is fully implemented, will have substantial increases in required contributions over current law.

But what you have to take into account is that these plans should be gradually coming up to the required contributions, so that it will not be an attempt to put an undue burden on any particular company.

But, under current law, we now have, in general, companies that can have a payout rate. They are seriously underfunded, and they will pay out $10 in benefits for every dollar that they put into the plan. They basically are wasting trusts, and until we deal with those wasting trusts, we will not be able to improve benefit security.

Mr. KASS. I think it is important to note that the overwhelming majority of plans are funded in excess of 110 percent of termination liabilities. Bear in mind that the approximately $40 billion in aggregate underfunding is in relation to a pension system that has aggregate assets approaching $1.5 trillion, which is a fairly modest percentage of that total system size. So the bulk of plans are not going to be affected.

Chairman PICKLE. I think it is fair to say that, if we take this approach that you have outlined, we are going to strengthen the plans, and it is going to require more money being put into funding, more restrictions on the terminations—that is, the withdrawal of assets—and it is going to be more difficult for the employers probably to meet these standards. I think that would have to be an assumption we would have to admit. Isn't that basically correct, that it is going to be difficult for them?

Mr. KASS. The bulk of plans are properly and well funded.

Chairman PICKLE. And you do not think that these changes would cause severe difficulties in many of the plans?

Mr. KASS. In certain plans they will; there is no question about that. But the key here is that we need to have rules that will assure that employers are properly funding the promises they are making.

Chairman PICKLE. There will be some changes. Will there be any loss of revenue in these kinds of changes?

Mr. KASS. Loss of tax revenue?

Chairman PICKLE. Yes.

Mr. MENTZ. I will answer that.

Mr. Chairman, there would be a revenue cost to this proposal. It is very hard to estimate this because it is hard to determine what the behavioral response and reactions will be. But the Treasury estimate is that it would be something like $100 million a year revenue cost to the Treasury.

Chairman PICKLE. Mr. Thomas?

Mr. THOMAS. There is obviously a flip side to that, though.

Mr. KASS. Yes, there is, sir, overfunding.

Mr. MENTZ. Yes.

Chairman PICKLE. Mr. Secretary, the staff tells me that it would be very helpful to them if you could submit for the record a sample computation under your proposed funding standard, so I hope you will make a note of that.

Mr. MENTZ. I certainly will.

Chairman PICKLE. They say it would be helpful if you could show the proposed funding requirements for past service over 30 years side by side with the proposed requirements.

Mr. MENTZ. Sure. We will get our staff with your staff and get them whatever they would like in terms of illustration.

Chairman PICKLE. We are going to be asking a lot of other questions of you.

I have observed from some of the companies that have talked with us about this that one of the biggest problems we face is that—I think they recognize that the plans have got to be changed; you have got to approach it from that standpoint and not just keep on raising the premiums. I think we all would agree on that.

But the problem is, if we make them too strict, if the amortization is too short, then you are going to cause people to get out of the defined benefit plans, and the danger is that we may hurt a lot of the smaller plans—when I say smaller, reasonably smaller plans—and the question is, how far can we go to make it workable and not be onerous? Isn't that a very difficult status we find ourselves in?

Mr. MENTZ. I think that that is a consideration that was important to all of us as we tried to develop this program. Examples of other options that were considered and discarded were to provide that, in the case of an overfunded plan, some of the excess would go to employees above the benefit promise made by employers and to mandate a particular minimum benefit under defined benefit plans, whether generally or upon termination.

Mr. Chairman, we rejected those and came up with the concept that an employer ought to be free to make whatever benefit commitment he wishes to his employees, as minimal or as substantial, and to update it or do what he wants with it over time.

But once he makes that commitment, it is very hard to argue that there should be a way for him to avoid that commitment, particularly if it goes onto the PBGC, which means that other employers, responsible employers with well-funded plans, have to, in effect, make it up by higher premiums. That is the other side of the problem that you and Dr. Utgoff were discussing earlier.

Mr. THOMAS. On the point of employer promises, Mr. Kass, would you reread your point No. 3 that you made from your notes?

Mr. KASS. The point related to employers being permitted to make the pension promises that they deem fit or that are subject to the collective-bargaining promise? I think that was it.

Mr. THOMAS. No, you went one, two, three, four, five, six, seven, and the third point was one that caught my ear. It couldn't catch my eye because I didn't have any written testimony.

[Laughter.]

Mr. KASS. Yes, I understand, sir. I think the point was that employers should not have the incentive or the opportunity to make benefit promises that they cannot keep or for which they are not fully responsible, and this obviously ties in to precisely what Mr. Mentz is saying here.

Mr. THOMAS. That they should not make promises?

Mr. KASS. They should not make promises they cannot keep, and they should keep the promises that they make, and they should be compelled to do so for——

Mr. THOMAS. I understand about getting them to keep the promises that they can make. How do we prevent them from making promises that they cannot keep?

Mr. KASS. By making the funding rules sufficiently stringent to require them to make contributions that will fund those benefits, and if they cannot make those——

Mr. THOMAS. So, if we cannot keep them from making the promises, we can sober them up in the promise-making procedure.

Mr. KASS. Very considerably, and it is not just the additional funding but this present disparity between what they are liable for versus what the plan is liable for that creates perverse disincentives for them to fund their benefit promises properly.

Now, on the point of flexibility, arguably, this proposal will drive some players from the system, the very players who presently or prospectively are dumping liabilities on the PBGC.

On the other hand, for the first time in a while, it does something positive for those employers that are properly funding their benefit promises. Those are the ones who, unfortunately, are usually penalized.

This proposal will give them some flexibility to access surplus with very substantial protections for participants, and, what is more, through the retiree health transfer provision, to create and maintain defined benefit plans because it will be through a withdrawal on a qualified basis, subject to these protections, that assets will be permitted to be transferred to these kinds of plans.

Mr. THOMAS. I want to get to those areas later, but I want to try to do it in an orderly fashion, probably tied to Mr. Mentz's testimony.

Obviously, we need to focus on the underfunded aspect of it, but on the proposals that you have for withdrawals of funds from the overfunded plans, have you looked at the possibility of the effect that it is going to have on the attractiveness of establishing new defined benefit plans? On the up side, have you looked at what might happen in terms of employers establishing defined benefit plans?

Mr. KASS. That is almost an impossible determination to make. However, I have just stated that I think there are important new sources of flexibility that are being offered here to employers, and I cannot help but think that will have a positive effect.

Mr. THOMAS. Thank you.

Chairman PICKLE. Dr. Utgoff, let me ask you, how has the financial condition of the PBGC changed since June of 1986, and what has been the main factor that has caused the change or changes?

Ms. UTGOFF. The financial condition has deteriorated substantially. At the end of the last fiscal year, the 1986 fiscal year, we had a deficit of very close to $4 billion. I believe it was something like $1.3 billion the last time I testified before you, in June of 1986.

The single biggest factor in explaining that is the termination of the LTV steel plans that had an underfunding of $2.4 billion.

Chairman PICKLE. Assuming that we will be studying this and looking at this question, and whatever we do could not go into effect until January 1, 1988, what do you think will be the status by the end of 1987 under present conditions?

Ms. UTGOFF. Our deficit will be worse.

Chairman PICKLE. How much worse? I am not trying to get a scare story, but I want to be frank here so that we all understand what we face.

Ms. UTGOFF. I don't want to scare you, but I am sure that you know that there are a number of large employers with seriously underfunded pension plans that may terminate them, and it may be this year, so that it depends crucially on whether those employers actually do terminate their pension plans. It could be substantially worse.

Chairman PICKLE. I have noticed that a lot of businesses are going under and the plans are being terminated with more rapidity than before, and if economic conditions do not improve, you are saying that, by the end of this year, we are going to be in substantially worse shape than we are now?

Ms. UTGOFF. No. There is very little chance that the deficit will go down, in fact almost no chance, and there is a significant chance that it will go up by another several billion dollars if we have other major terminations.

But I think an estimate without those terminations is on the order of a couple of hundred million dollars. If we have the large terminations, it could be several billion.

Chairman PICKLE. All right. Now, the next question I want to ask you is, without discussing the specifics of the variable-rate or risk-related premium at this time—and Mr. Thomas has touched on that—can you tell me when we could expect to receive your proposal? Did I understand you to say a month or two?

Ms. UTGOFF. Yes. We plan to have the proposal up here in the early part of April. The early part of April is our current schedule.

Chairman PICKLE. Now, Dr. Utgoff, will the minimum funding waivers, the changes recommended by the proposal we have, would it stop the abuses of minimum funding waivers which you have complained about in the past?

Ms. UTGOFF. It will cut down on the attractiveness of funding waivers.

Chairman PICKLE. How much?

Ms. UTGOFF. It will reduce the number of funding waivers that are available over a period, which is very important. We have just recently faced a company that had five funding waivers, and we are going to get a 2-percent recovery on our claims in bankruptcy from that company. If you can reduce that number to three, that will be a very substantial improvement, and I think that that will have a major impact on our losses.

Chairman PICKLE. Let me pursue that a little bit further, then. Will the stricter minimum funding standard that is being proposed, or that you may have advanced, prevent the continued deterioration of a plan's funding even when the plan is meeting all the requirements of the law?

Ms. UTGOFF. Yes. That is the purpose of the proposal.

Chairman PICKLE. Are you all in agreement that you think the waivers should be reduced substantially?

Mr. KASS. Yes.

Chairman PICKLE. Any disagreement?

Mr. KASS. No disagreement.

Ms. UTGOFF. No disagreement.

Chairman PICKLE. All right.

If the proposed minimum funding is adopted, do you believe that the overall level of funding in the plans which are underfunded today will improve?

Ms. UTGOFF. Yes.

Mr. MENTZ. Yes, sir.

Chairman PICKLE. You think so?

Ms. UTGOFF. Definitely.

Chairman PICKLE. What do you expect will be the long- and short-term impact on PBGC of these tighter minimum funding standards?

Ms. UTGOFF. The short-term impact will be very limited. We face significant amounts of underfunding. If plans with those amounts of underfunding terminate, we will have substantially higher deficits.

This is not a quick fix for the PBGC. It is an approach to improve funding, and any kind of transition rules that would not overly burden companies would mean that it would be not an im-

mediate improvement in funding but a long-term approach to improve funding in companies that are now underfunded. Even more crucially, it would make sure that companies that now have relatively healthy pension plans do not become seriously underfunded when they face incentives to take money out of their pension plan to solve their business problems. That is a very important part of the proposal, but it is not an immediate fix for the PBGC by any means.

Chairman PICKLE. Well, Mr. Secretary, you proposed to revise the maximum period for amortizing these waivers from, what, 15 years to the period determined by multiplying 15 years by the plan's funded ratio. Now, based on past experiences, what effect would this change have on the amortization plans allowed and contribution requirements for plans receiving waivers?

Ms. UTGOFF. The way to think about that is that the average plan that we now terminate, or that comes to us for us to become trustee of, is 40-percent funded. So, for those plans, you would multiply 40 percent times 15, and they would be amortized over that period. So a little bit less than half, like 7 years.

Chairman PICKLE. Approximately one-half, then?

Ms. UTGOFF. Yes.

Chairman PICKLE. Well, now, let's see. We've got some more questions on the funding waivers. The administration proposal states that additional restrictions on funding waivers designed to ensure that they would be granted only when absolutely necessary would be considered, only when necessary. That is rather hard to determine sometimes. What additional restrictions do you have, Mr. Mentz, that would bring this about?

Mr. MENTZ. Well, Mr. Chairman, in addition to tightening the standard, the interest rate would be modified so that it would be more nearly equivalent to a commercial loan rate for a relatively poor credit. The notion is that if a trust accompanying a defined benefit plan is in a financially troubled State, a funding waiver may be prolonging the inevitable and resulting in greater liability to the PBGC, potentially less secure benefits for the employees, and therefore the overall effect for the plan is not a healthy one. It is healthy only if the plan and the company can work their way out of a distressed or financially troubled situation.

But I think, from evidence that we have seen, and particularly that the PBGC has seen, funding waivers tend to get us into worse difficulties probably more than they help. I think Dr. Utgoff would perhaps have more specific experience with that, but I believe it reflects, does it not, your approach?

Ms. UTGOFF. Yes, Mr. Chairman.

Chairman PICKLE. What is the rationale—I guess that may be a good way to do it—for limiting the number of funding waivers? You go from, say, 15 down to 3. What is the basic rationale behind it?

Mr. KASS. Five to three.

Ms. UTGOFF. It is five to three.

Chairman PICKLE. What, five?

Mr. KASS. In 15 years.

Chairman PICKLE. Yes. Well, what is the rationale? I am just trying to understand why you do it. I guess what I am saying, is

there a relationship between the number of waivers that a plan would receive and whether the plan continues to terminate with an insurance program claim? Is there a ratio between them, or just what is your basic rationale?

Ms. UTGOFF. The basic rationale is that funding waivers should only be available for temporary problems, that in fact it will help ensure the continuation of the plan and a well-funded plan.

With 5 years of continuing funding waivers, you have to begin to question whether in fact the problem is temporary. So cutting down from five to three is a way to say it is only a temporary problem.

Chairman PICKLE. Thank you, Dr. Utgoff.

I think Mr. Thomas has a few questions of the panel. Mr. Thomas?

Mr. THOMAS. Thank you, Mr. Chairman.

I don't want you to alternate back and forth too much, so I am trying to jump in as we move.

Obviously, as you were formulating your proposal, I am sure you looked at the 1984 asset reversion implementation guidelines that were issued. You could have revised those guidelines to a certain extent and accomplished some of the things that you wanted to do.

Could you, for just a minute, for the record, talk about the decision to go with legislation rather than revision of the guidelines and why there couldn't be some combination of administrative revision of the guidelines with legislation?

Mr. MENTZ. Mr. Thomas, I will answer briefly and then let Mr. Kass elaborate.

The guidelines apply on a plan-by-plan basis, and we see this as more of a consolidated plan, affiliated group problem. Certainly the case where one employer has both underfunded and overfunded plans, we do not believe, could be worked out without legislation. In other words, a modification of administrative guidelines would be inadequate.

Furthermore, the funding rules seem to be clearly in need of repair, and it is very hard to do that—I think it is not possible to do that—by administrative action alone.

Mr. THOMAS. Well, by hindsight, apparently the funding rules needed to be repaired when ERISA was originally passed.

Mr. MENTZ. That is right. That is the one part of ERISA that seems not to be working.

We originally, thought about the guidelines and whether an approach of just dealing with withdrawals would be possible, and it became apparent that, in order to deal with this problem in a comprehensive way, you have got to get into the underfunding as well as the overfunding, and the guidelines deal only with overfunding.

Also, the guidelines do not provide an asset cushion for ongoing plans to maintain benefit security and fund future benefit increases benefit accruals after the date of termination/reversion and reestablishment. So, really, the guidelines are kind of a band-aid. We need something more here, we think. We need some surgery.

Mr. Kass, do you want to elaborate?

Mr. KASS. Yes. Withdrawal of assets from a continuing plan is currently forbidden under ERISA, so there would be no way, administratively, to accomplish that approach.

As you recall, one of the purposes of the guidelines was to provide a mechanism that would not deprive employers of the ability to continue to furnish defined benefit coverage to their employees, and the special protections accorded to workers like the annuitization of all accrued benefits, whether or not eligibility requirements had been satisfied, was part of the way the guidelines accomplished that.

However, in concluding that the guidelines, in compelling employers to terminate a plan to access surplus, impose unnecessary and disruptive consequences on both employers and workers, we moved toward the notion of a withdrawal mechanism that would be coupled with substantially greater protections for workers in the form of the cushion concept that is explained in the proposal. Therefore, the bottom line is, the only way this approach could be done is by legislation.

Mr. THOMAS. It makes sense to examine an employer not in terms of any one plan that it may have for one group of employees but for all of the employees so that if you have one overfunded and one underfunded, you cannot allow them to do that.

I do not understand—and I received a definition from Mr. Posner regarding the law for a controlled group—what led you to move to a controlled group in terms of trying to handle overfunded or underfunded termination relationships? Is there any other area in the law which links controlled groups in a similar fashion?

Mr. MENTZ. I think, Mr. Thomas, the rationale is that, if you did not have an affiliated group concept here, it would be possible for an employer to split up his organization into separate subsidiaries, as was really done in a fairly outrageous way before ERISA. You put all the high-paid people up in the parent company; you put the low-paids in a subsidiary. It used to be that you could provide a very discriminatory kind of plan or that the high-paids get a very extraordinary benefit and the low-paids get very little. That was pretty much outlawed by ERISA.

Mr. THOMAS. That was before ERISA, though.

Mr. MENTZ. That was before ERISA, but you can do the same thing with funding under current law by having multiple plans within the controlled group; and if we did not aggregate companies under our proposal, in one company you could have a well funded plan; while, in a subsidiary, you could have an underfunded plan. Under current law, if both plans terminated, the people in the well-funded plan would have benefit security; they would get their full benefits. The people in the underfunded plan may not. I think in order to do——

Mr. THOMAS. But—excuse me—without a controlled group concept, couldn't you achieve the needed benefit structure within each of those groups, within each of the subsidiaries?

Mr. MENTZ. Well, I think you still have the problem of, if one subsidiary covers, let's say, your hourly people in the factories, you can have that underfunded and have another plan in another company, a member of the group, overfunded, and you will have the

basic problem that the proposal is getting at. That is the reason for the affiliated notion.

Mr. THOMAS. So you feel that that is essential in creating a balanced structure?

Mr. MENTZ. That is right, and it is in——

Mr. THOMAS. Initially, it is kind of hard to assume that one group is going to be held responsible within a controlled-group concept.

Mr. MENTZ. Well, it is not very much different from the consolidated return regulations which provide liability of each company for tax liability of the consolidated group.

Sometimes you get into issues where some of the affiliates are owned partly by some interest outside the group, and the way that works—it is not really a legislative problem—but the way it works in private life is that there are reimbursement agreements so that if a subsidiary that is partly owned outside the group has a liability relating to some other member of the group, tax liability or what have you, there is a makeup arrangement so that those shareholders effectively are not prejudiced.

Mr. THOMAS. And the other side of the coin is that if one of the groups is driven by collective-bargaining arrangements, then it certainly again sobers up the employer in terms of the kinds of decisions that it makes in giving away benefits. I will not say they were never intended to be fulfilled, but at least it would have been difficult to do. That holds them a little bit more responsible.

Mr. MENTZ. Yes.

Mr. KASS. And what is more, Mr. Thomas, the idea is not entirely a novel one. It was introduced in SEPPAA in connection with the termination of underfunded plans where the obligation to pay the unfunded benefits is passed on to the controlled group.

Mr. THOMAS. Thank you.

Thank you, Mr. Chairman. I have more questions, but I want to wait to go into the health benefit area.

Chairman PICKLE. Let me ask you a question on the increased employer liability. One of the basic principles that you are advancing in this proposal is that you want to be sure that there is enough money in there to pay off these plans and that PBGC has got enough money to have the full amount.

Now, if you make these changes that we are talking about, particularly as to employers, what effect would this change have on the ability of financially distressed companies to obtain loans? If you make these tough, strong changes, will it affect businesses ability to get loans, or ability to, quote, stay in business or keep their plans?

Mr. MENTZ. Mr. Chairman, I would not intend that a particular business would be unaffected. I think there clearly will be cases where a business that is in some difficulty and has its plans underfunded, if you impose a new liability on the businesses, there is no question it is going to adversely affect credit.

Chairman PICKLE. Well, how many companies, or what percentage, or how big a problem would it be—because it is going to be real problem now, once you do—if we do what we think is right, what effect will it have out there in the real world? Can you tell us? Can you anticipate?

Mr. MENTZ. I don't know that I can tell you exact numbers of companies. I think we maybe can try to look at that for you in some quantitative fashion. I think that would be desirable with respect to your question.

I do think that the way we are running now, if we don't do something like this, we are going to have the PBGC in worse and worse and worse shape, and the net effect is going to be that the companies that are effective and competing and prosperous are going to be paying the freight for their underfunded brethren.

Chairman PICKLE. Well, Mr. Secretary, I would like for you to give us some estimate of how you think it would affect these kinds of businesses to, quote, stay in business or to keep their plans, because I think that gets to be——

Mr. MENTZ. Certainly.

Chairman PICKLE. We need to know, really, what to anticipate, because we know it is going to have some effect on them.

Mr. MENTZ. Yes, it will clearly have some effect. I will try to get you some quantification.

Chairman PICKLE. Well, what effect do you think these changes will have on the willingness of companies to agree to further benefit increases?

Mr. KASS. Agree to make benefit increases?

Chairman PICKLE. I beg your pardon?

Mr. KASS. I am sorry; I did not hear the question.

Chairman PICKLE. I said, what effect do you think that will have on the willingness of companies to agree to have future benefit increases?

Mr. KASS. Companies that offer these programs and that make benefit increases that are responsible know that whatever benefit increases they make, they are going to have to fund.

Chairman PICKLE. What effect will this have on labor union relationships?

Mr. KASS. We have had discussions, sir, since the release of the proposal with representatives of organized labor. I am still not entirely clear as to what the response to the proposal of organized labor is. I don't know exactly what the impact on the collective-bargaining process will be, but I think the key point is that the proposal leaves to the collective-bargaining process the determination of what the benefit ought to be and only concerns itself with being sure that that benefit is properly funded.

Mr. MENTZ. Mr. Chairman, I think Mr. Thomas has got an apt phrase for the changed relationship. I think the employers would be sobered up by this proposal, and in terms of benefit increases, I think they would be much more careful about making promises that they might not be able to keep. I think it is better to have them in that position rather than to have an inflated promise made that is probably not going to be realized or is realized only at the expense of greater deficit in the Pension Benefit Guaranty Corporation.

Mr. THOMAS. And, on the employees' side, that the promises that are made are much more realistic. So they can anticipate that what they are going to get is what they had been told they were going to get.

Mr. MENTZ. That is precisely right.

Chairman PICKLE. Well, as we increase benefits, that puts a heavy responsibility on the employer. I would think that union negotiations are going to be a serious part of this for both employees and the employer.

Assuming that you would have an increase in benefits and the union gained a one-dollar increase in their benefits, or $5. Now, as I understand it, that is an increase for that particular labor negotiation for that year, and each time that is done, that is another increase without providing, I assume, for additional financing, and that gets compounded up, and your responsibility to the employee gets heavier and heavier.

So wouldn't the employers look very skeptically at increased premiums when labor negotiations would allow them to have protection? Or do I understand how it works?

Mr. KASS. Any time there is a benefit increase, it can be expected that there will be additional required contributions. For the well-funded——

Chairman PICKLE. Well, it would be from that particular point on, but doesn't that go back to all those benefits that have been built up 5, 10, 15, 20 years?

Mr. KASS. With respect to past service credit.

Chairman PICKLE. So isn't that a heavy burden on an employer?

Mr. KASS. Again, it is going to depend upon how well funded that plan already is.

Chairman PICKLE. But if it is not well funded and it just kind of went on——

Mr. KASS. Then the amortization schedules are essentially going to remain the same as they would have been.

Chairman PICKLE. And that is going to say to that employer, he might say, Well, I just don't believe I can stand this any more and I want to opt out.

Mr. MENTZ. Well, but Mr. Chairman, I am not sure if that is any worse than—in fact, I think that may be preferable to the situation where the employer says, I don't know where I am going to get the money, but I will make the promise, anyway, and maybe I will win the lottery. That is not a very acceptable situation.

Mr. THOMAS. Obviously, we need someone representing collective bargaining at the table if we are going to continue the discussion, with the reaction that they would have.

Mr. MENTZ. I don't believe they have a prepared statement, Mr. Thomas. [Laughter.]

Chairman PICKLE. But we will be hearing——

Mr. THOMAS. Mr. Chairman, the point I want to make is that you have x number of dollars, and there are pressures in terms of fringe benefits and wage increases. When there is a chance that you can promise something that you may or may not have to deliver on, you can reduce the actual wage increase for this promise that may have a half-full glass rather than a completely full glass effect. I will repeat my phrase that it will sober up both sides, because the employer is going to have to talk about fewer wage increases available if he is going to have to increase the premiums.

The thing that I like about it is, everybody gets realistic and nobody sells tomorrow. They sell today with a rational plan. And it is not much fun when you have to play that kind of game, but it is

certainly healthy for the entire system and for workers who put in 20 years and should get what they have been promised.

Mr. KASS. All we are doing here is removing the illusion of a free lunch.

Chairman PICKLE. Well, the original requirement under ERISA is a little bit less onerous or difficult for employers than your proposal would be. At least you say now that that employer is going to be liable for the full amount, full benefit, and they are less than that—I don't know how much, but they are less than that in the present system. What is the rationale for us having been more lenient years ago, or why do you want to move it up now?

Mr. KASS. I guess my answer would be a comment on your first point: Why was it ever the way it is? Why should an employer ever have been liable for less than the termination liability of the plan? I cannot figure that one out, sir.

Mr. MENTZ. Well, but I might just say, historically, you know, ERISA was in 1974. It was, at the time, a major step in employee benefits, and I think it is just a matter of time. I think perhaps they did not anticipate the problems that have occurred in the last 12, 13 years.

We are seeing where the defects in ERISA are, and this is really trying to focus on them and correct them.

Mr. KASS. But, philosophically, there was never justification for it.

Mr. MENTZ. That is right.

Chairman PICKLE. Well, I don't remember it, and I just wondered why. I guess it just happened.

Well, under your plan, Mr. Secretary, you say that after an employer terminates a plan, that employer would be precluded from having another choice, say, for a period of what, 5 years?

Mr. MENTZ. That is right.

Chairman PICKLE. What is the purpose of the 5-year rule?

Mr. MENTZ. It is to discourage terminations. In other words, if a termination occurs—and assume there is only one plan in a simple case—then the employer would be able to get back everything in excess of termination liabilities. In other words, it is very similar to where we are today under current law, under the guidelines.

If an employer had the ability to reestablish a plan the very next day or very shortly thereafter, that would simply be an avenue around these rules that require a benefit cushion in an ongoing situation. So that is the reason. It is certainly not, as it might appear, to try to discourage defined benefit plans. It is designed to protect plans from termination.

Chairman PICKLE. Will that be an incentive for a business to say, Well, if I just don't have but one choice, one in 5 years, I just don't believe I will get into it?

Mr. KASS. Well, sir, the flexibility afforded by the withdrawal provisions, especially where accrued benefits are annuitized, is so substantial that it is going to be an unlikely event where an employer will choose to terminate all plans as a means of, if you will, maximizing the reversion amount.

However, in the case where that is the employer's choice, it is going to be occasioned by one of two factors. One is going to be acute financial distress where the employer simply can no longer

fund a defined benefit program, and in those cases, we really would not want to provide the kind of, if you will, inordinate flexibility of the present guidelines to allow the employer to strip assets down to the level of termination liabilities and then restart a plan often when it really does not have the capacity to fund the plan adequately.

The other reason that may occasion an employer's decision to terminate all plans is a competitively driven decision to offer a different kind of benefit program, and the administration does not believe that the rules should work to the disability of employers to make a kind of benefit promise or to offer a kind of plan that is consistent with their competitive and economic circumstances.

Chairman PICKLE. Mr. Thomas, do you have any other questions at this point?

Mr. THOMAS. I want to talk about the rationale on the health benefits portion. If you want to cover areas before that——

Chairman PICKLE. That is all right. Let's go to that.

Mr. THOMAS. All right, let me go to that.

Chairman PICKLE. I have some on excess plan assets, too, so go ahead with your health benefits.

Mr. THOMAS. I understand the desire to take moneys that may be in an overfunded way and move them to another area which needs some assistance in terms of underfunding. As I understood the plan, that is the only option provided in terms of funding another area. Or does the employer have the ability to move the funds to other defined contribution plans?

Mr. MENTZ. Well, there would really be only two options. If a plan is overfunded so that there are assets in excess of the cushion in a particular plan, there can only be a withdrawal if the rest of the plans maintained by that employer are up to snuff. If they are, the employer has two options. He can withdraw the money, the excess funds—which is, for many companies, a significant benefit—a very simple withdrawal, no paperwork and so forth. When he does withdraw it, he pays ordinary income tax on it and the 10 percent tax that was enacted on removal of assets on qualified plans that we dealt with last year in tax reform.

The other option is, he could transfer that on a tax-free basis to a VEBA, a 419 welfare benefit fund, which would be available to fund retiree health benefits. These are health benefits for people who have already retired. We know that there are fairly significant liabilities outstanding which employers have for these retiree health benefits.

We thought, frankly, that this would be an advantage of the plan, that it would be a way for employers to use excess assets without paying current tax and yet use them for the funding of obligations that they have incurred.

Mr. THOMAS. What was the rationale for providing only that option on a tax-free incentive basis for funding if they had other plans that they could move the moneys to as well?

Since the decision was between the employer and the employee on the funding of the pension program and now it is overfunded, why can't the employer and employee carry on a discussion about where they would like to direct those moneys, rather than having this administration provide an incentive to move it in only one par-

ticular area, thereby removing the freedom of the employer and employee in making that decision?

Mr. MENTZ. Well, Mr. Thomas, I think those moneys in excess of the cushion in that case are the employer's moneys. The philosophy of the proposal is, the employer is obligated to optimally fund a plan. If, for one reason or another, the plan becomes overfunded, the group——

Mr. THOMAS. I understand that, but you have created an incentive in your plan, with the tax provisions, to move it into only one other area.

Mr. MENTZ. All right. Well, the question——

Mr. THOMAS. What was the social benefit that the Reagan administration decided was paramount in moving it in that area?

Mr. MENTZ. The question is, what do you do with this excess? The philosophy of the administration is, the excess is not to be divided up or given to the employee or what have you; the employer is entitled to use it and, in the normal course, it would just be withdrawn and tax would be paid on it, and that would be that.

There is one incentive. We looked around and we found that there is a series of obligations here that are outstanding, the retiree health benefits. It would be beneficial, it would be desirable, for employers to be able to do this on a tax-free basis.

Now, maybe Mr. Kass can give a little more of the background, but that, at least, is my understanding of it.

Mr. THOMAS. Why wouldn't it be desirable to move it tax-free into other areas that the employer and employee have agreed upon?

Mr. KASS. We want to maintain incentives for the maintenance of defined benefit pension plans which provide stable, secure, predictable retirement benefits for rank-and-file workers.

So, at the heart of the proposal are what we believe are incentives to employers or for employers to continue their commitments to these plans. One of those incentives is to offer special flexibility to employers who retain their defined benefit plans to withdraw surplus over and above minimum benefit security level and allocate it to these funds, which leads us to a second explicit public policy objective here, and that is to use these excess funds to defray the cost of funding already promised retiree health benefits for existing retirees.

So, yes, there are, if you will, public policy objectives that were considered here, and the limitation on the ability to transfer on a tax-free basis reflected our sense of the priorities.

Mr. THOMAS. Was there any discussion behind closed doors in the Reagan administration about the philosophical implications of the directed tax benefits idea in terms of an incentive for social purposes?

Mr. KASS. I guess I did not follow your question.

Mr. THOMAS. Do you want me to be more specific?

Mr. KASS. Yes, please do.

Mr. THOMAS. Well, you've got two problems here and you are trying to solve both of them. You use tax incentives as a device to try to solve both of the problems. Isn't that correct?

Mr. KASS. Well, there is already, under section 401(h), an ability of employers to prefund, to a limited extent, health benefits for

participants covered by pension plans without having to pay unrelated business income tax on the buildup of assets in the fund. So this is really not breaking new ground in terms of the availability of a tax preference here.

Mr. THOMAS. All right.

Mr. MENTZ. Mr. Thomas, there is also a very pragmatic answer to your question, and that is, if these moneys can be moved around in a variety of ways, the proposal gets more expensive. So there is a revenue reason.

Mr. THOMAS. Thank you, Mr. Chairman.

Chairman PICKLE. Thank you, Mr. Thomas.

Let me turn to another subject, and I know, Mr. Secretary, you need to be leaving, so we will not hold you much longer, and we are going to submit to you several questions in writing, to each of you.

Mr. MENTZ. That is fine.

Chairman PICKLE. And we would like for you to respond, if you could. As you would understand, this is just the opening shot on this program, and we will be listening to businesses and labor and other organizations to see how they view this.

With respect to the employer's access to the excess plan assets, I will ask a broad question: Who really has the right to these excess assets?

Mr. MENTZ. I think the administration view is that, in a defined benefit plan where an employer has made a benefit promise, as long as that promise is secure—and that is why we have built in this cushion concept—as long as the benefit promise is secure and the employer is not treating adversely other participants and other plans, I think our view is, very clearly, that those are excess assets that ought to be accessed by the employer. In other words, it is the employer's money, not the employees', provided the pension promise is secure.

Chairman PICKLE. Do all of you others agree to that?

Mr. KASS. Yes.

Chairman PICKLE. Any disagreement? Mr. Kass?

Mr. KASS. No disagreement, sir.

Chairman PICKLE. Now, a company makes a contribution into a pension plan, and he puts in a million dollars. That is tax-free; that is, it is deductible and he can write that off, and he does not have to account for that. He puts it in to start a plan that would pay for his employees so they would have retirement money.

Good times come along. They expand and they grow and develop. The stock market booms. They have invested and made a good bit of money. Now that $1 million now is worth $10 or $100 million.

If they withdraw it, we have, what, a 10-percent excise tax now? We try to get some recoupment for the fact that we have given that tax-exempt status. Is that enough of an excise, the right balance of tax and incentive? Is that a good test to maintain?

Mr. MENTZ. Well, you recall when we were debating that subject last year, depending upon how long the money is in a fund and the performance, you could come up with a sliding scale tax that would be appropriate at different levels.

However, I think 10 percent is a fairly good compromise and a fairly good number. Better to have one level of tax than a complex

tax that would be confusing, particularly to small businesses that maintain these kinds of plans. So my short answer is yes.

Chairman PICKLE. Well, has the administration given any consideration to taking that increased value of the retirement fund to provide for increased benefits?

Mr. MENTZ. Yes, we did give consideration to that and decided that if the plan has assets that have increased in value and the employer, accordingly, wants to make, either of his own volition or a collectively bargained agreement or what have you, if he wants to make an increase in benefits, a promise to increase benefits, he should be free to do so.

If he should decide not to do that for competitive reasons, he does not have to. He is paying his employees adequately and so forth. We felt that it would be inappropriate to require him to do so, and that would be Federal interference, if you will, with the free-market system and the employee-employer relationship.

Mr. KASS. I think we also have to look at the incentive effects on funding of mandating a sharing of surplus, if you will. To the extent that there is an extra surcharge on the reversion amount where a termination occurs, in essence, we have redefined the termination liability only for overfunded plans. It takes the form of a mandated benefit, and it creates a disincentive for employers to fund plans properly. We worried about that, too.

Chairman PICKLE. Well, I do not know if we can draw any conclusion or pass any judgment on who has the right to these excess benefits. It is arguable either way you want to look at it. I am sure we are going to have testimony from other groups who think that they have a right to some of that money, too; that is, since it is tax-exempt and since it has grown, they ought to have a right to some of that.

I guess we would all say fundamentally that what you really have is a right to have full retirement benefits as promised.

Mr. MENTZ. That is exactly right.

Chairman PICKLE. Now, how much more of that, I do not know; that may be questionable. But I just wondered, if the assets belong to the employer, then why do you want to limit the withdrawals to one every 10 years? Why not every year?

Mr. MENTZ. I think a withdrawal every year might well affect the security of the benefit promise. In other words, if you withdraw every time the stock market goes up 5 points, then the stock market goes down 100 points, you may have employers playing the market, in a sense, with not really their own money but with the employees' money. Of course, I recognize that with a full employer contractual liability, the pressures are less. I think that is the reason.

Mr. KASS. And while the proposal is intended to give employers flexibility to withdraw, it is not intended to encourage withdrawals.

Chairman PICKLE. I do not think this committee is attempting to pass judgment on a lot of these questions we have raised. What we have today is your proposal and how you think it would work. As I said from the beginning, I think it is basically a good start, and we will be anxious now to get into testimony from some of these others, and ask them questions.

Dr. Utgoff, we are going to be interested in getting the recommendations on this variable-rate thing that you are going to propose for us.

I think it is obvious that your proposal has got a lot of details that have to be examined and worked out, and I would say again that I think, in broad principle, your proposal has a lot to recommend for it. So we are not being negative on this thing.

I am going to ask that our staff and your staff, Mr. Secretary, work closely together because we are going to be holding additional hearings on this just as quickly as we can be given clearance to do so.

It is obvious, as I said at the beginning, that we have got a serious problem in this area; that PBGC, set up with good intentions, is now on the verge of having a great catastrophe if we had a sudden turndown in the economy. It would be an enormous development. We have got to find some answer other than just trying to increase premiums.

I do not think we ever dreamed, when we started PBGC, that we would be having premiums possibly staring us in the face in the magnitude of $20, $30, $40, and none of you did. We have to be practical, though. There are things that may or may not happen. We have got to try to be prepared for it.

So I would say that I do not believe we have many more important problems facing the Government than trying to be certain that these plans are properly funded and that the people who put the money into it through their employer would have full termination benefits when their time comes; that is, full benefits. How we do this is not going to be an easy problem to solve, but I think we will be examining that.

Now, our staff is going to submit to you several questions that we have not touched on this morning, and as we hear these other witnesses, I am sure that you will be asked to respond, and in turn. You may want to come back and make additional statements. We would anticipate that. But the chairman has asked us to get into this question immediately, and we will.

Mr. Thomas, did you wish to be recognized?

Mr. THOMAS. Thank you, Mr. Chairman.

I think the primary reason we are quizzing you the way we are is that we do not have some of the specifics in front of us, and it is difficult to analyze exactly how some of the mechanics of the proposal would operate.

But I want to applaud the administration's proposal. It is just hard for me to understand why some of these problems were not anticipated in 1974. I guess commonsense is hindsight by another word. But that still does not fully explain to me why something as fundamental as requiring employers to live up to their promise and making sure that the promise is structured in a way that they can live up to it, and the prospect of overfunding, were not anticipated. But we can belabor that.

What you have, I think, is a rational proposal which deals with the real problems in a way in which both employer and employee can only stand to benefit. Your proposal provides for a much more rational and realistic procedure for both sides to move into a pension program.

I just think that the points that were brought out by the Labor Department need to be underlined as coming from this administration, because it seems that there are folks who are focusing on people who need some help because promises have been given and they are not being honored. I think it shows a degree of compassion for the working person that often is not focused on in the political rhetoric.

What you have here is a practical formula—which may or may not need to be fine-tuned as we listen to other folks—to solve a very real problem for people who not only build hopes and wishes but very real, concrete plans on what they have been promised and find out that, after years of living up to their side of the bargain, the other side is not being met.

It ought not to be shoved onto society to pay the obligations that were made by an employer. I think that what you have provided for is a rational, minimally fair procedure for resolving what is a problem not only in this area but also is a problem in a lot of other areas as well. That is, people promise benefits today that they may not be able to deliver tomorrow but sometimes also knowing that they are not going to be able to deliver them tomorrow.

Thank you, Mr. Chairman.

Chairman PICKLE. Before we adjourn, Dr. Utgoff, you had mentioned earlier several companies within the last, let's say, 2 or 3 years who have been engaged in practices that were questionable and should not have been permitted and may or may not have been specific cause for difficulty they are now facing in the pension program.

You are in a better position to know what they are doing and how they are operating than we are, because you are full time at this subject. Just as we know there are several companies—Allis-Chalmers, Wheeling Pitt, LTV—who have caused big difficulties for us, there are bound to be others in the offing or in the wings that you know something about.

I am not asking you to give public testimony about who those companies are that are cutting the corners or may be in big trouble or that we are facing a problem with, but I would hope that, in talking with our staff, you would give us some indication of the types of companies, what is going on, so we can look at it and know practically what is taking place.

When it happens and the damage is done, we try to amend it and we try to catch up. But since we are into this subject now, I wish you would give our staff just all the information you can, pursuant to your strictures on disclosure, so that we can work closely together.

Ms. UTGOFF. Yes, I would be happy to do that.

Chairman PICKLE. It would be very helpful to us.

That applies, also, Mr. Secretary, to you and your organization. As far as this committee is concerned, we are going to try to have a quick and thorough examination of the pension program so we can look at some of the options and take the proposal you have made and see if we can do something with it; that is, by way of recommendation. We are not a legislative subcommittee, but we think it is tremendously important. If we are all in general agreement, then we ought to move forward on this thing as quickly as possible.

Mr. THOMAS. Mr. Chairman, could I amend your request to not just give us the horror stories? But as we are doing in the medical area now is it possible for you, in examining those companies that seem to follow patterns that are not a problem, to put together some guidelines so that others can see what is most appropriate in order to avoid the problems?

Ms. UTGOFF. Yes.

Mr. THOMAS. We always point to the negatives, and it would be helpful if you could put together some general guidelines of what seems to be the key to putting together programs that work.

Ms. UTGOFF. Yes.

Mr. THOMAS. Thank you, Mr. Chairman.

Chairman PICKLE. Mr. Secretary?

Mr. MENTZ. Mr. Chairman, I just wanted to thank you and Mr. Thomas and the other members of this committee for your obvious deep interest in this subject. I agree with you that it is very important, and I appreciate your recognition that this is a very responsible proposal, and we are certainly prepared to work with you diligently and expeditiously to try to get a legislative product together here.

Chairman PICKLE. Well, I in turn thank you for making this proposal. We made that request to you last year when it came time, and we upped the premium from $2.60 to $8.50, and that was a hard thing to swallow. We are not going to swallow it again that easily until we look at the other alternative of how we make changes in the plans. So that is what we are looking at. If we make the changes, we may be causing hardship and we may be causing, in some areas, more damage than we do good. But it is a problem that is going to get worse instead of get better, so we have to look at it.

Mr. Kass, did you want to make a comment?

Mr. KASS. Yes. I would just like to say in closing that I appreciated the comments of Mr. Thomas that this proposal is a compassionate response, a response that is very sensitive to the situation and needs of participants. In speaking on those matters, I was speaking for the administration, and I would like to apologize for any misunderstanding in connection with the opening remarks. We will supply you a written statement there, and we very much appreciate the opportunity to appear before the committee, sir.

Chairman PICKLE. I thank you all. Mr. Secretary, again, when you come up, the committee requires your advance statement. We need to look at those to see what is being advanced, and when you come, and others with you, and they read from prepared statements but say we cannot have a copy of it, that is not acceptable, so we will not do that any more, I am sure.

The committee then will stand adjourned.

[Whereupon, at 11:26 a.m., the hearing was ajourned.]

[Submission for the record follows:]

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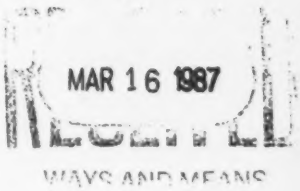
March 13, 1987



Joseph K. Dowley, Chief Counsel
House Committee on Ways and Means
1102 Longworth House Office Building
Washington, DC 20515

Re: Administration Proposal on Funding and Termination of Pension Plans

Dear Sir:

We strongly support the Administration's proposals on the funding and termination of pension plans, particularly the provision that would clarify the ability to fund retiree health benefits from excess pension fund assets.

The position of the Internal Revenue Service is that pension fund assets cannot be transferred to a 401(h) retiree medical account. We believe that the I.R.S. position is wrong, but in any event it is ill-conceived. It encourages conservatively managed plan sponsors to terminate their defined benefit plans and start over again so the fund assets can be more efficiently redeployed. Termination of plans is not in the best interests of employees.

In the alternative, a conservatively managed plan sponsor must invest fresh money to fund retiree health benefits -- money that could and should be more efficiently invested to create new jobs.

This letter may be included in the public record.

Yours very truly,

William T. Marsh
Vice President & General Counsel